LOS ANGELES PUBLIC LIBRARY
MAR 10 1955
SOCIAL SCIENCES

Inter-American Economic Affairs

Venezuela's Sow-the-Oil Policy . . . . . *Virgil Salera*

Peruvian Monetary and Foreign-Exchange Policy, 1940-1945 . . . . . *Rolf Hayn*

U. S. Government Assistance to the Underdeveloped Countries, 1945-1953 . . . . . *J. Fred Rippy*

The Economic Development of Nicaragua . *Andrew G. Frank*

Broadening the Industrial Front in Venezuela . . . . . *Virgil Salera*

Argentine Relations with the Export-Import Bank, 1934-1945 . . . . . *Edward O. Elsasser*

Index by Subject and Author, Volume VIII

Vol. 8 SPRING 1955 No. 4

Inter-American Economic Affairs

Editor
SIMON G. HANSON

Editorial Board

P. T. ELLSWORTH, *University of Wisconsin*
RUSSELL H. FITZGIBBON, *University of California*
ALVIN H. HANSEN, *Harvard University*
SIMON G. HANSON, *Consulting Economist*
C. H. HARING, *Harvard University*
ROBIN A. HUMPHREYS, *University of London*
LELAND H. JENKS, *Wellesley College*
SANFORD A. MOSK, *University of California*

Published quarterly at Washington, D. C. Subscription price, $6.00 per year, postpaid to any address in the world. Mail all communications to Managing Editor, Inter-American Economic Affairs, P. O. Box 181, Benjamin Franklin Station, Washington 4, D. C.

Vol. VIII, No. 4
Printed in U. S. A.

Inter-American Economic Affairs

VOLUME VIII SPRING 1955 NUMBER 4

Venezuela's Sow-the-Oil Policy 3
Virgil Salera

Peruvian Monetary and Foreign-Exchange Policy, 1940-1945 23
Rolf Hayn

U. S. Government Assistance to the Under-Developed Countries, 1945-1953 43
J. Fred Rippy

The Economic Development of Nicaragua 59
Andrew G. Frank

Broadening the Industrial Front in Venezuela 69
Virgil Salera

Argentine Relations with the Export-Import Bank, 1934-1945 87
Edward O. Elsasser

Index by Subject and Author, Volume VIII

The opinions expressed by authors of articles in *Inter-American Economic Affairs* do not necessarily represent the views of the editors of the magazine. *Inter-American Economic Affairs* takes no editorial position on the issues that may arise in inter-American relations. The editors do undertake to provide a hearing before a critical reading audience for writers who have something significant to say in this field. Responsibility for views expressed and for the accuracy of the material in the articles rests with the individual authors.

Venezuela's Sow-the-Oil Policy

By VIRGIL SALERA*

Suppose that the Lone Star State had remained an independent country, possessing only a modest agriculture until the oil gushers had been found. Assume also that as a result of large exports of oil, the "Texas dollar" had appreciated, despite average labor costs that were about as high as those in the United States. Let us say that the "Texas dollar" had appreciated in value so that it fetched two United States dollars in the foreign exchange market, thereby making imports cheap in relation to typical home production. Finally, suppose that most people in Texas were very pleased with the economic benefits derived from oil, but were not sure how long they could count on abundant oil produced at low cost. Would the Yanks have any reason to fail to understand why the Government of Texas and its people earnestly desired to

* Director, Mantaro Valley Survey, Huancayo, Peru. This paper is a chapter from a book-manuscript titled "Venezuela's Dynamic Economy," completed in October 1953. Pressure of work prevents the author from revising it for presentation as an independent paper. The manuscript was the outgrowth of a suggestion, made by the writer in his capacity as an economic adviser and approved by the then-President of the Corporación Venezolana de Fomento (later Minister of Agriculture), that an objective work was needed which would inform the intelligent layman of the nature of Venezuela's economic growth, the role of American capital in the country's development, and the importance of the economy to the United States and the free world.

I wish to express my indebtedness to the many individuals without whose help the process of becoming acquainted with Venezuela would have been an unbearably slow one. Outstandingly helpful have been Sr. Rafael José Crazut, my assistant while on leave from the Consejo de Economia Nacional; Dr. George Coutsoumaris, and Mr. John Heilman, Director of the Consejo de Bienestar Rural. Mr. Heilman read the entire manuscript, offered the widest cooperation in the use of information at the disposal of his organization, and frequently volunteered comments on matters of substance about Venezuelan agriculture. The Consejo has made signal contributions to the improvement of Venezuelan agriculture, for which Mr. Heilman's admirable technical and personal qualities are largely responsible.

In the manuscript referred to above, the present paper, as Chapter 6, was preceded by background chapters on Venezuela's resources, the structure of the economy, oil, and iron ore.

pursue a long-range policy of diversifying the economy, to be ready for the "rainy day" when the fruits of oil had dwindled to insignificant proportions? Clearly, the Texans would want to expand cotton production, examine the possibilities of producing most of their cement requirements, look into the prospects for a steel industry, expand textile production, develop the agricultural potential of the lower Río Grande Valley, and so forth. Some day, they might not be able to pay for customary imports of cotton textiles, cement, steel, and various kinds of farm and industrial products.

If "Venezuela" is substituted for "Texas" in the foregoing paragraph one obtains a substantially accurate idea of the policy which the Government in Caracas calls *sembrando el petróleo*—sow-the-oil policy. There is a determination to take a forward look, to prepare for the "rainy day" when the wasting asset, oil, is no longer capable of lubricating the wheels of a fast-moving but consumption-based-on-imports economy. The resources, if they are properly husbanded, will in all likelihood prove adequate to the task; Venezuela knows how to save.

Nature of Policy: Official View. Official pronouncements on "sow-the-oil" policy are rather fuzzy. They amount to the proposition that the country must use a large part of the oil revenues to improve and diversify the rest of the economy, especially agriculture, to expand educational and health facilities, enlarge the road system, modernize ports, and so forth.[1] These are worthy objectives ,of course. But a mere enumeration of aims clearly provides no guidance for policy-making. What is needed is a theory of economic development applicable to Venezuelan conditions, one that provides a basis for making choices intelligently. The theory should help to answer the question: How should the available capital be apportioned among the alternative ends of (1) agriculture, (2) industry, and (3) basic services (such as power, transport, irrigation works and communications)?

[1] For instance, the Paley Commission's Report 10, "Venezuela Sows the Petroleum," *Resources for Freedom*, Washington, 1952, which is presumably based mainly on Embassy dispatches sent to the State Department, reflects the fuzziness of official Venezuelan policy. Thus, the Report is little other than a recitation of scattered improvements that have been effected in the general Venezuelan economic scene. It is devoid of analytical content.

A Suggested Framework. Although Venezuela is perhaps more heavily dependent upon a single export than most other "single export" countries, its situation is also better than that of most export economies. This is mainly because the demand for petroleum is relatively steady, with the additional prospect that oil (as a depleting resource globally) is likely to improve pricewise in relation to most commodities as the decades wear on (over most of the life-span of the Venezuelan oil industry, barring obsolescence).

It follows that though imports are heavy, especially in the case of many of the relatively easily replaceable ones such as foods, Venezuela can afford large imports. As long as the country has large exports, it can afford the convenience of a sizable import trade. The money and incomes derived from exports cannot indefinitely accumulate within the country (or show up externally in the form of ever-rising foreign-exchange reserves). But the imports preferably should help to expand and diversify the economy.

New industries will generally be import-saving over the long term if selection is based on economic criteria. For a time, however, new industries will expand imports, particularly of capital goods. This should involve no great difficulties, since export proceeds can pay for such imports. Much the same may be said about the expansion and diversification of agriculture.

Most American economists who have made brief studies for agencies of the Venezuelan government seem to be agreed on one thing. They conclude that where the relative productivity of agricultural and industrial projects are fairly evenly balanced, several reasons may be adduced for giving preference to agriculture. First, food is the least postponable of all types of consumption. It is not possible quickly to reduce food imports materially if a drop in exports should make it necessary to effect a retrenchment of purchases from foreign sources. If a choice has to be made, it is better to become relatively independent of food imports than, say, textile imports. Yet the country at the present time is relatively more independent of textile imports (from generally high cost domestic production) than of food imports. Second, the American economists believe that it is often possible to expand agricultural output very greatly through a combination of a

small amount of capital and the teaching of new techniques. Thus, high returns to capital may be realized in agriculture—at least for a time.[2] Third, a well-developed agriculture is a partial depression hedge, by giving many unemployed industrial workers an opportunity to move in temporarily on relatives who operate farms (partly on a subsistence basis). It is not suggested that a mass movement to the farms is an ideal measure in depression, but this outlet is nevertheless of some value on social grounds. Fourth, the rapid growth of population suggests the desirability of giving special attention to agriculture. In the Venezuelan case, it would be best to have food production expand more rapidly than population. Fifth, agriculture may hold better promise of future exports than manufacturing. This export consideration may be very important at a future date when it will be necessary to have new exports to replace oil. Sixth, the level of living of the agricultural sector is a good deal lower than that in urban communities. Hence, there is a social motive for giving preference to agriculture when productivity differences are small as between a new investment in industry and a new one in agriculture.

The economists whose case is summarized above labored under one handicap. They were not able to make individual industry cost analyses. I have made a number of such analyses, and have directed the research of others, on the basis of the available official and unofficial information. With some exceptions, the smallest efficient plant is found to be too large for the present Venezuelan market. When, moreover, such a plant is not too large, a monopoly problem is almost always involved. Both conclusions can be reached by a priori methods, to be sure. Obviously, however, verification based on analysis of carefully prepared engineering studies represents a far more solid basis for policy.

Contrast the industry case with that of agriculture. There is no problem of farm size, at least in relation to the market, and of course there is nothing even remotely akin to a monop-

[2] Evidence that I have seen does not bear out this hypothesis. It appears that the development of Venezuelan agriculture requires a relatively large amount of private and social capital, though nothing like the amount of capital per worker that is needed in, say, oil, iron ore, or an electric utility plant.

oly problem. Moreover, it is next to impossible to "transplant" farm production units internationally, whereas it is almost literally possible to ship a whole modern factory to Venezuela or to construct one that duplicates an existing foreign plant. These contrasts are especially significant if the problem is viewed in the light of Venezuela's rapidly growing population.

I would therefore make a significant alteration in the position of the visiting American economists. I would not argue that preference should be accorded agricultural development only when the relative productivity of agricultural and industrial projects are fairly evenly balanced. First, such reasoning makes no allowance for the monopoly problem to which I have referred. Monopoly is much more serious than the milder market form known as oligopoly, which is so commonly lumped together with the rare bird monopoly in the typical American discussion of the "monopoly problem." (Of course, oligopoly situations are also found in Venezuela.) Second, if study shows that it is a matter of indifference from a local-cost-in-relation-to-import-price angle whether investment be made in an industrial or agricultural project, in all probability a larger and more economical industrial plant will be feasible, say, a decade hence, when population and per capita real income will be larger. Both considerations lend support for a policy of giving marked preference to agriculture, especially technologically-young tropical agriculture. Varieties of hybrid seed corn that give yields of 100 bushels to the acre in Marshall County, Iowa, won't work on a Venezuelan hillside or in the valleys near Lake Valencia, just a few degrees north of the equator.

"But," it will be said, "you are arguing for a lopsided economy—an oil, iron ore, and agricultural Venezuela. Surely investment must also be encouraged in a variety of industries." This, however, is tilting at windmills. I would not rule out investment in industry, or even protection to industry. Much of such investment is consistent with the thesis that development policy, for the reasons cited above, should give marked preference to agriculture. Concretely, I would allocate a part of the "development budget"[3] to the industrial sector; but the lion's share, say over the next five or ten years, would be

[3] Minus that part of the "budget" that is reserved for investment in basic services, such as power and transport.

devoted to agriculture. Incidentally, in some cases projects would overlap; for instance, the development or expansion of the paper industry would facilitate the expansion and increase the efficiency of sugar production by using bagasse in paper-making in preference to a lower-order use as fuel.[4]

Specific Aspects of the Framework. The above analysis is couched in generalities. This has been necessary in order to deal fairly clearly with the basic principles involved. It is now imperative to get down to particulars, though I shall avoid anything savoring of a blueprint. A blueprint would necessarily imply far more knowledge than currently exists and also the resolution of some complex policy and technical issues.[5]

1. Private Planned Investment. One of the first things that it is necessary to know is the amount and types of private investment that individuals and firms plan to realize without government assistance. This is necessary if only to make it possible for the government to plan policy actions and the allocation of its own resources among the different sectors of the economy. At the present time, the main research work along these lines is being carried out by the Central Bank.[6] (Informational reciprocity is not necessarily required, inasmuch as the government usually keeps out of the industrial area.)

2. Investment in Basic Services. Once the volume and types of private investment are known (or adequate estimates thereof have been made), the government is likely to want to plan its investments in the area of basic services: transport, power, irrigation, and education. These are investment areas that provide foundations for development and that are not likely to have much appeal to private investors partly because of the risk involved, which turns mainly upon the long period of

---

[4] The introduction of paper-making will also improve the employment picture in sugar areas, by expanding employment somewhat during the "dead season" of sugar production, say, by scheduling the non-regular work load with respect to the paper industry in the "dead season."

[5] For instance, how large a national electric power and distribution plant should Venezuela have in, say, 5 years; in what proportions should private utility operations, government-owned facilities, and facilities of the oil and iron companies be combined; and what should be the relative contribution of hydroelectric and thermoelectric plants?

[6] See *Memoria, 1951*, Banco Central de Venezuela, Caracas, 1952, Chapter IX.

time over which the operations may be amortized. In some types of basic services, moreover, public use alone is intended; highways are an example.

Timing is the most important part of the development problem in the case of investment in basic services. If they are built too late, the effect will be to hold back the development of the economy. The lack of roads, for example, will retard the expansion of agricultural production in areas of good land that are now inaccessible. On the other hand, if the basic services are provided on a large scale at too early a date, the effect will be to burden them with excess capacity for many years. In such an event, the capital represented by the over-investment could have been far more effectively used in other ways.[7]

Rules of thumb will probably have to be applied in the allocation of resources for investment in basic services. Quantitative ideas of present capacity in each area of basic services will have to be kept up to date, so that it will be easy to spot excesses and deficiencies in relation to industrial and agricultural demands presently being made upon such services. Areas of excess capacity will be marked for low priority, while attention will be given and plans made for the expansion of capacity in those lines that seem to be deficient. The expansion could be planned with reasonable approximation to the likely realities if guided by an informed consensus as to the assured near-term growth of the main service-using industries over the next several years. Continuous checks would have to be made, of course, to keep basic service investment on the right track. By such means it will be possible to obtain a working idea of the yearly magnitude of desirable investment in basic services. The funds available for developmental investment in agriculture and industry could then be found as the residual.

3. Protection. A word is in order with respect to broad aspects of the question of protection. Some protection to domestic agriculture and industry is indispensable in the Venezuelan case. Given the lopsided character of the economy, or, what is the same thing, the transient role of oil,

[7] There is evidence that costly irrigation works in some areas are being used only to the extent of about a third of their capacity because of a lag in the expansion of acreage in crops that require irrigation.

protection is entirely consistent with "sound" economic reasoning. Not only are there true infant industry situations that merit protection, but some assistance along protectionist lines is justifiable as a means of accelerating the diversification of the production base and thus of easing the inevitable transition to a situation in which oil exports have dwindled greatly in relative importance. However, industries receiving protection must be subject to continuous checks with respect to quality and reasonableness of prices. Fortunately, the official advisory body in this field, the Consejo de Economía Nacional (National Economic Council, which includes private participation), is on record as strongly advocating such checks. This is a difficult area, one that abounds with controversy. In view of the fact that America, the world's main creditor nation and leader of the free world, makes such an economically indefensible use of "peril points" and "escape clauses," an American economist may even be accused of failing to come to the table with clean hands. However, I have been no defender of American protectionists.[8]

4. The Place of Subsidies. Protection and subsidies are the main devices available to a government such as Venezuela's for the purpose of directing and accelerating investment along the paths of economic diversification that are necessary to achieve long-term viability. Subsidies are a direct means of accomplishing by budget outlays roughly the equivalent that is achieved by protection or other assistance against imports. Thus they are a means of activating private investment along lines that otherwise would not be developed. It might also be said that the subsidy technique is but a means of channelling a part of the earnings from oil, indirectly by way of the Treasury, into specific avenues of industry or agriculture whose development it is desired to accelerate or make possible. Subsidies have advantages over the tariff: they make it possible to nail down the dollars-and-cents cost of protection in an objective budgetary manner and, being a budget outlay that can be reduced in the annual budget-making process, they facilitate the digging of their own graves; that is, subsidies can be terminated or modified downward at an earlier date than is generally possible in the case of tariff protection.

---

[8] See Enke, S., and Salera, V., *International Economics*, Second Edition, New York, Prentice-Hall, Inc., 1951.

5. The Primacy of Private Investment. Enough has been said above to make it clear that the prime mover in Venezuelan economic development should be private enterprise. The development job facing the country is of such huge proportions, managerial skills of high quality so uncommon, and technical ability over a wide range of commodities and processes so inadequate that government operation could hardly provide the system of incentives that is needed. The broad technical base on which a diversified and efficient economy rests requires that adequate incentives exist across the board. Nor must the incentives apply only to producers directly. Individual saving must be expanded and channeled into new and varied productive enterprises. Risk-taking must be encouraged and adequately rewarded, with few reservations based on egalitarian considerations. All of these requirements are best met, as the experience of countries in various stages of development shows, under a system of private production for profit—a system that emphasizes opportunities for individuals desirous of expanding the size of the national production pie, not one that stresses how best to share the existing and perhaps shrinking pie. Hence, the government should enter into production only when it is clear that the industry in question is needed in the national interest but is not sufficiently attractive to private capital, or when private capital has had a chance and failed to provide service of adequate quality at reasonable prices.

6. Allocation of Funds for Development. Given the foregoing, how should the government apportion its development funds among alternative uses?[9] I have argued above that the circumstances of the Venezuelan case suggest the need for a policy of marked preference for agricultural over industrial development.[10] What, however, is meant by "marked pref-

[9] Budget items bearing indirectly on development, such as general education, are excluded from my concept of "development funds."

[10] In the light of recent tendencies in some informed quarters to use the ratio of labor employed in agriculture to that employed in non-agricultural activities as a benchmark for measuring progress in economic development, my position may seem to represent a formula for retrogression. This, however, would only be a superficial conclusion. For an example of the use of the indicated ratio as a criterion, see H. W. Singer, "La Mecánica del Desarrollo Económico," *El Trimestre Económico*, Oct.-Dec., 1952. I have dealt critically with the matter in "Nota sobre la Mecánica del Desarrollo Económico," *Ibid.*, April-June, 1953.

erence"? Unfortunately, there is no objective way of determining the matter, at least in quantitative form. A rough and arbitrary procedure might be to ascertain the amount of funds that are available after meeting annual requirements for investment in basic services, provided that not over half of total development funds are allocated to such services. The government could then apportion two-thirds of the residual to agricultural development and the remaining one-third to the fostering of new, and the expansion of existing, industries. After, say, a decade of experience along such lines, a thoroughgoing review should be made, and the apportionment basis changed if necessary. Incidentally, I should judge that about $150 million a year would be available for the above developmental purposes—a not inconsiderable sum.

The "hen and egg" problem is involved in any such procedure for using development funds. Specifically, the allocation of investment as among basic services, agriculture, and industry involves intricate interrelationships; the position of the three may be likened to three balls in a bowl: the position of each affects and is affected by the position of the other two. As stated previously, it is not necessary to rely on elaborate and time-consuming analyses in order to carry out investment in basic services. Power and transport facilities exist everywhere in some degree. (Irrigation works may be absent in some areas, however.) Where existing capacity is underutilized, nothing need be done. (However, such cases deserve study, if only to indicate how to avoid similar instances of specific overinvestment.) In the cases in which capacity is inadequate or barely adequate, the pressure of demand on capacity will clearly indicate the need for expansion over a 3- or 4-year period. The degree-of-present-use criterion, as supplemented by analyses of additional demands that will arise from new industries that are to be established, will provide a serviceable index of priorities. Policy-makers should err, if necessary, in the direction of providing somewhat too much capacity rather than too little.

A. The Agricultural Case. Strictly economic criteria should govern the apportionment of agricultural development funds within the several fields of Venezuelan agriculture. That is, priorities should be based on carefully estimated relative returns on investment, insofar as it is possible to measure such returns. When it is not possible to measure them, the

policy-maker should rely on the best informed judgments about the relative rate of return that can be expected from the investments in question; but he should proceed more cautiously in such cases, and call for frequent reappraisals as additional data become available. If possible, tariff protection should have no place in the program.

Concretely, if an expanded supervised credit program is found on analysis to be the one that will yield the greatest return on development investment, the "agricultural development fund" should first be used in such a program. How much should be invested in a credit program? All of the year's available funds, if necessary. Even all of two consecutive years' funds might be required. The specific amounts would depend on the evidence. When studies of the alternative uses of funds show that additional investment in supervised credit will yield a smaller rate of return than an equivalent investment in, say, land reclamation, it will be time to stop making further investment in the credit program and to begin investing in land reclamation. And so on for other investment outlets within agriculture.

Parenthetically, some expenditures outside the "development budget" will of course affect plans and prospects within the budget. Thus, technical agricultural experiment station work, carried out jointly with the researches of the agricultural colleges but as a part of the regular work of the Ministry of Agriculture, may suggest the profitability of, say, expanding irrigated rice cultivation in the Amacuro Delta. In this case, the government's general educational (and ministerial) outlays will effectively supplement the "development budget."

Losses incurred in the use of "agricultural development funds" would be borne wholly by the government, as a contribution under the sow-the-oil policy. That is, the losses would be regarded as having been incurred as part of an organized effort to expand and diversify national output. The individual farmer would share some of the risks, however, to the extent that some of his own assets are risked in losing ventures. But he would not be expected, as an individual, to incur special risks under the program. On the other hand, gains (such as net earnings under credit programs, net proceeds from the sale of reclaimed land, and so forth) would return to the "agricultural development fund." Hence, the fund would be

essentially a revolving fund—unless gross returns on agricultural investment average less than the administrative costs of running the programs.

B. The Industrial Case. There are two peculiarities of the industrial case, as compared especially with that of agriculture. First and foremost, the timing problem favors at least some delay in industry but not in agriculture, as previously explained. Second, the "import component" in the case of new industries is proportionately much larger than in the farm case. Most of the industrial capital equipment must be imported, and the ratio of imported equipment to total plant investment is higher in industry than is the case of a typical farm.

As previously stated, Venezuela would be well advised to enjoy cheap imports and to forget about high-cost local industries *if* so many of her economic eggs were not in a big and valuable but precarious petroleum basket. Sooner or later, oil will give out. It is possible, at a much earlier date, that oil may become markedly obsolescent. At the time of writing, for instance, the Atomic Energy Commission reports a sensational development with respect to achievements at its Reactor Testing Station in Arco, Idaho. It is now possible for an atomic plant to "breed" its own fuel. Specifically, the Commission reports that the burning of uranium 235 not only produces the heat that is necessary to operate a power plant, but changes non-fissionable uranium into fissionable plutonium at the same time and at "a rate that is at least equal to the rate at which uranium 235 is being consumed." Experiments have shown the possibility of achieving a degree of efficiency that was undreamed of just a few years ago. Given the vast technical resources being devoted to reactor aspects of atomic energy, it is to be expected that the hurdles to cheap energy—and they are still substantial—will eventually be overcome. They may even be overcome within a decade.

Technical developments of this sort are bound to affect the Venezuelan economy to a marked degree, mainly because the country's oil production consists to so large an extent of the heavier crudes. These are precisely the grades of oil that move into exports mainly in the form of fuel oil, the product that constitutes Venezuela's chief export to the United States.

The upshot of this discussion, then ,is that it would be

extremely shortsighted for the country to take the easy view—to enjoy cheap imports while they last, and deal with the transition from oil to a non-oil status on the eve of the transition period. Rather, an immense amount of work lies ahead if economic energies are to be suitably redirected. We have already pointed out, in a general way, what must be done in the vital field of agriculture. How should the problem of industrial development be met?

Two courses are open, assuming that the government's direct role as a producer is minimal. The country could continue the existing policy of granting liberal tariff protection to new industries (besides making occasional use of import quotas). This has the effect of severing what might be a direct connection between oil and industrialization, by placing the burden of establishing new industries on the consumers of their product (including industries users). Moreover, the policy does nothing to deal with the monopoly problem. I should like to suggest an alternative course of action that faces up to each of these difficulties.

Under the program to be suggested, industrialization would be part of the development plan based on oil revenues and, in the consumer interest, would take shape within a market situation that would be far more competitive than has been the case in the country to date. First, a word as to what is meant by gearing the development of industries to revenue from the petroleum industry. It has already been pointed out that oil exports make possible cheap imports. Given the uncertain profitable life-span of the industry and also the uncertain obsolescence factor to which it is exposed, it has been argued that policy should deliberately forego some current benefits in the form of cheap imports. In what way should some imports be displaced? I would shun the methods of import restriction on the grounds that they are likely to be inflationary. Rather, I would operate through the budget. Fiscal policy, more than any other, accounts for the marked rate of growth that has been achieved without hardly any inflation other than that which has occurred in countries that are the sources of Venezuela's imports. If the development budget proper amounts to X million bolívares, I would have the government aim (on a trial-and-error basis) for a general budget surplus of, say, one-fifth X. Such a surplus formula

would be subject to annual review, and the projected surplus reduced if market supplies of goods are abundant in relation to monetary demand. In all probability this budget arrangement would permit the release of enough ordinary imports to offset, more or less, the increase in capital goods imports that would be traceable to the implementation of a development program.

On what basis would priorities be established in the industrial field? I would divide prospective new industries into two broad categories, based on an efficiency criterion. One would consist of industries which careful research showed involved unit factory costs, including the going rate of return to capital, of not over 10 per cent in excess of the average landed cost (exclusive of duty) of comparable imports from the cheapest foreign sources during the past twelve months;[11] the other category would be made up of new industries the cost studies for which indicated a factory cost of more than 10 per cent in excess of the landed cost of comparable imports.

For the first group, the government would undertake to underwrite construction costs up to the amount necessary to reduce the calculated factory cost per unit, after making allowance for the capital subsidy, to the landed cost of imports. The only strings which the government would attach would be to insist that the private parties involved be financially responsible, that they waive tariff and/or other protection, and that they not be allowed to transfer ownership to a new ownership or managerial group without the government's approval. The order in which new industries would qualify would be in the order in which they approximated the landed cost of imports, to insure that the maximum of industrial development be achieved per million bolívares of subsidy. Subsidies would be granted annually on this basis up to the full amount of the "development budget" that is to be allocated to industrial development. I would draw the line at the 10 per cent disadvantage level, and transfer any unexpended sums to the Treasury's general fund (or correspondingly reduce the planned government surplus).

In addition to the capital or construction subsidy, the government would grant qualifying firms a two-year exemption

[11] Based on the assumption that the domestic firm or firms would capture most if not all of the market.

from all taxes. There are bound to be differences of opinion as between interested private groups and the government with respect to the calculations on which a given capital subsidy would permit firms to earn the going rate of return on capital invested in new industries. It is better, in my judgment, to give industry the benefit of any doubt in the form of an assured tax exemption than in the way of excessive subsidization as such or through conventional protection.

Note the advantages of such a scheme. The main one would be the benefit to consumers in the form of domestic production that would sell at prices no higher than comparable duty-free imports.[12] The arrangement would assure that subsidized firms would compete with foreign suppliers for the Venezuelan market, and yet such firms would be enabled to price their products at levels that reflected the going rate of return to capital in Venezuela (which is higher than the going rate in most foreign export markets). For promotional reasons in the early years, Venezuelan firms might be able, by temporarily reducing the yield on capital, to undersell foreign competitors in order to win a following for their product. This may be necessary in many cases, in view of the marked brand preferences for a number of foreign (and especially United States) products in the Venezuelan market. I am confident that two advantages will accrue to Venezuela under such a development policy as compared with the existing situation in which industries of varying degrees of suitability win tariff protection by the usual technique of exerting political pressure. First, aid will be confined to industries most likely to merit government assistance. The system would amount to something like an infant-industry arrangement, with the equivalent of a terminal date in the form of monetary aid the size of which is known in advance. When it is recognized that hundreds of American industries that won tariff aid decades ago using the infant-industry argument are still benefiting from the tariff, this advantages takes on some significance. Second, though this point in particular cannot be documented in the nature of the case, I am definitely of the opinion that the Venezuela economy will obtain more soundly

[12] To the extent that the domestic plant would be located in or near the main interior market, it would have a cost advantage over imports under our proposal.

based industrial development per million bolívares of expenditure under this arrangement than under any other that is administratively feasible.

Concretely, I have compared the cost of the proposed capital subsidy with the extra outlays that Venezuelan consumers now have to incur in purchasing imports by virtue of the existence of the tariff. No allowance is made in such calculations, however, for merchandising mark-ups that reflect the duty. Hence, the comparisons conservatively estimate tariff burdens. On this basis, the capital subsidy that would be required to permit a glass bottle industry to enjoy production costs equal to the landed cost of imports, exclusive of duty, would represent from one to two years' duty collections. Even though newsprint has duty-free status and specified users of multiwall bagging paper are exonerated from duty on a license basis, the calculated capital subsidy for a bagasse-based paper industry would amount to just over a year's duty collections at present high duty levels. The tariff equivalent of a capital subsidy works out at two to three years in the case of a plant making 20 per cent superphosphates from local phosphate rock, and about four years from an ammonia sulphate plant.

Any consideration of the tariff equivalent of a capital subsidy arrangement naturally is subject to change in the light of the dynamics of industrial development. The electrolytic chlorine- caustic soda industry is a case in point. In terms of the present industrial cost of electricity of just under two cents (U.S.) per K.W.H., the tariff equivalent works out at about a year. If, however, Venezuela establishes a steel industry in the Puerto La Cruz area, electric power generated from near-by natural gas would cost only about one-half cent per K.W.H. At such a power cost, a Venezuelan chlorine-caustic soda industry could export chlorine profitably without any government assistance whatsoever, even assuming that the plant would be only of moderate size (and thus of sub-optimum efficiency) because it was geared to meeting nothing more than domestic requirements for caustic soda (which are higher tonnagewise than chlorine). If it were decided to install a plant of a size that would yield maximum economies under known technology, Venezuela could profitably export both chlorine and caustic soda. Since technical developments of the indicated sort are bound to occur, it would be necessary

to submit any subsidy program to periodic re-examination in order not to prolong subsidy arrangements when the facts no longer warrant them.

The capital subsidy cases considered above may be regarded almost as random samples under Venezuelan protectionism. What they indicate is that capital subsidies may prove to be a new and far more efficient means of dealing with the encouragement of new industries. Clearly, the capital subsidy arrangement has very great advantages over conventional tariff protection as a device for fostering economic development.[13]

There will be some difficult problems, however. Perhaps the main one concerns the impact of the arrangement upon the over-all demand for imports, especially in the first years of the program. If, as I suspect, the principal effect will be to increase the demand for imported capital goods in relation to imported consumer goods, the arrangement is likely to have some inflationary effect in the consumer goods sector. However, this effect is not likely to be great. This is partly because most of the probable small decline in total imports will be offset by the planned budget surplus. There are also two other reasons why the inflationary impact is likely to be small. It will be possible to pay for any unexpected additional imports by eating into the foreign exchange reserves, especially since such an expansion of imports will be short-lived. To the extent that additional imports are paid for by drawing down on exchange reserves, there should be no noticeable upward pressure on prices in Venezuela in the face of a temporarily increased total demand. The final reason is this: new industries in most cases can be established within a year or less, with the result that it will not be necessary to wait long for an expansion of import-competing domestic production. Thus, the outlook for an early expansion of supply is likely to offset any desire that may exist to augment inventories in antici-

[13] To be sure, there would be a loss of revenue from customs. This would really be a blessing in disguise, however, inasmuch as more equitable revenue sources are available. For example, there might be a modest increase in the relatively low-rate personal income tax. Moreover, there would probably be a loss of revenue from internal taxes as a result of the two-year exemption that has been proposed. This would be only temporary, however, inasmuch as the scheme is likely to expand the tax base by enlarging the scope of industry.

pation of higher price levels. Moreover, an early expansion of import-competing production should make possible decline in imports after a short period, permitting the country to restore the level of its exchange reserves. Also, to the extent that the process leads to an expansion in the number of sellers (an unchanged number of foreign sellers and the new Venezuelan sellers), there should be a secular tendency toward lower prices or smaller price increases than would otherwise have been the case. It is not so much the increase in the total number of sellers (most of whom will be foreign) as the rivalry that will result from the entry of domestic firms desirous of carving out a part of the market for themselves, that will probably account for an increase in the over-all competitiveness of the market.

A problem will be involved in the extension of the arrangement to industries presently protected by the tariff. If the scheme outlined above is put into practice and works satisfactorily, the public is likely to plead (understandably) for the replacement of the existing tariff mechanism with the selective capital-subsidy device. Existing firms whose cost structure is low enough so that they fall within the 10 per cent rule present no problem, or only a small one. There is no reason why they cannot readily be accommodated, by way of the regular capital subsidy coupled by a renouncement of tariff protection—plus effective checking to see that new wholesale and retail prices reflect landed costs exclusive rather than inclusive of duty. What, however, about existing sheltered industries whose costs exceed the benchmark of landed cost exclusive of duty by 10 per cent? Should they be maintained, if necessary by continuing tariff protection? Or should protection be denied and the firms allowed to get along as best they can for as long as they can?[14] If the system here proposed is put into effect and works satisfactorily, there is likely to be strong pressure to deny tariff protection. To the extent that that is the case, there will of course be an improvement in the long-term outlook for the economy. Any reallocation of resources should not be very difficult, in view of the rapid over-all expansion of agriculture and industry.

---

[14] Such firms will be able to continue production as long as price covers their marginal prime costs, and so may be able to exist for a considerable period even if they are denied tariff protection.

The Outlook. There is every reason to believe that, with wisdom and courage, Venezuela can point the way to a means, consistent with the canons of efficiency, by which a single-export country may transform itself into a broadly based economy. The nation will have to face the issues involved without having the advantage of foreign experience in meeting comparable problems. This is partly because there simply have not been comparable cases in other countries; and in those few cases in which a very rough approximation may be said to have existed at one time (Chilean nitrates come to mind), the people did not have the foresight to anticipate the revolutionary character of the transition ahead.[15] But the lack of parallel cases abroad, from which inspiration might have been drawn, is no reason why an alert people, with the resources at hand that give every promise of assuring success, cannot use economic analysis to cope with an unavoidable problem.

In this connection, there is a simple test which can be made in assessing a nation's capacity for economic development: what is it saving and what is it doing with its savings? By this test Venezuela must be ranked as a stellar performer. Savings are high[16] by comparison with practically any free country in the world; more important, the savings are put to good use in internal development, as capital formation proceeds with vigor in nearly every sector of the economy.

Another important and favorable factor deserves to be mentioned. As things stand today, the country does not need foreign capital as such apart from operations in a few technically advanced industries that cater to exports. That is to say, the country does not need foreign capital in the net sense. It can pay its way developmentally, provided that advanced countries do not erect Chinese walls against its exports. This is not to argue, however, that Venezuela is not using foreign capital. It is, and very definitely and conspicuously; such capital supplements its own resources. And here a significant contrast may be made between Venezuela's case and that of most other underdeveloped areas. In many other cases the

---

[15] To be sure, synthetic nitrates hit Chile like a bolt from out of the blue.

[16] For the particulars, see the Central Bank's studies in *Memoria, 1951*, Banco Central de Venezuela, Caracas, 1952, Chapter 9, and *Memoria, 1952*, Banco Central de Venezuela, Caracas, 1953, Chapter 8.

capital-supplying countries must *pump in* capital—in the form of credits or free grants. Often such capital doesn't do much good, because the recipient nations are not capital-minded: there is no widely-based desire for capital's benefits and little disposition to incur the sacrifices that will be required if success is to be achieved, qualified local technical personnel are often absent, and there are few organizational brains to plan for its efficient use. Rather, there is a starry-eyed hope that someone else will direct capital wisely, efficiently and productively, coupled with superficial prophecies of pie in the sky.

Under such conditions foreign capital is not likely to be sucked in; the local spirit and the domestic prospects do not exert an effective pull on foreign capital. Venezuela may be rightfully proud of the fact that capital has not had to be pumped into her economy.

The inter-American political and economic environment has been an additional favorable factor. The dominant industrial nation of today is also the leader of the free world, whose most respected citizens recognize the nation's responsibility to assist other free nations that are doing a serious job of trying to meet their major problems. Venezuela's resources clearly are counted on to help the free world carry the day. If it should ever be necessary, therefore, I feel confident that Venezuela can count not only on America's sympathetic understanding of her difficulties but also on tangible assistance in meeting the goal of a viable economy in anticipation of the period in which oil is incapable of carrying the economic load.[17]

---

[17] In studies of countries that are experiencing rapid development, it is customary to pay considerable attention to the inflationary consequences of domestic policy. Since World War II, that is, during the period of greatest economic growth, however, Venezuela has had very little inflation of domestic origin. Rather, the rise of prices has mirrored the sharp rises in world prices; that is, the foreign inflations have been transmitted to Venezuela. Policy in effect has been to adjust to the rise of foreign prices, rather than to offset the impact of inflationary world prices on the local economy by way of a strong deflationary policy. Other oil-rich economies have been less fortunate; Iraq, for instance, has been experiencing a situation in which expenditures on development have caused serious inflationary consequences. For particulars, see *The Economist*, London, July 18, 1953, p. 190.

Peruvian Monetary and Foreign-Exchange Policy, 1940-1945

By ROLF HAYN*

During World War II, Peru, like other Latin American countries, suffered a considerable inflation. Notwithstanding price controls, the wholesale price index increased by about 75% between the end of 1940 and that of 1944. The money supply rose by about 170% during the same period. This inflation was of primarily domestic origin. The sol, Peru's monetary unit, was stabilized at the beginning of the war in Europe at a very low rate, but as a result of the inflation the country grew into this exchange rate. As the war approached its end, it became increasingly apparent that the sol was overvalued.

After a brief discussion of the manner in which the sol, following a rapid fall in relation to the dollar, was stabilized in May 1940, we shall trace, and discuss the causes of the inflation of the war period. This will then enable us to determine the impact of the exchange rate upon the economy, and to evaluate the adequacy of the country's foreign exchange policy.

The Stabilization of the Sol. At the end of 1939, the outbreak of the war in Europe and the fall of the pound sterling led to strong adverse pressures against the sol. As Table I indicates, the sol depreciated by about 21% against the dollar between August 1939 and May 28, 1940. On the latter day, it was stabilized in relation to the dollar.

The stabilization was accomplished with a voluntary control mechanism agreed upon by the Minister of Commerce, the Central Bank, and the main exporters. The latter were to sell their foreign exchange returns to the Central Bank at the "official" rate. The Central Bank would distribute this exchange to the commercial banks on the basis of their customary share of the market. These banks would then also

* The author is Assistant Professor of Economics at the University of Arizona. He would like to thank Professor V. Boland of the same institution for his suggestions.

TABLE I

FOREIGN EXCHANGE RATES AND THE EXPORT PRICE INDEX
AUGUST, 1939—DECEMBER 1940

Date	*Soles per Dollar*	*Soles per Brit. Pound*[1]	*Sol Export Price Index*[2] *1913 = 100*
1939			
August	5.36	25.05	188
September	5.36	21.90	188
October	5.36	23.80	185
November	5.37	24.90	192
December	5.50	22.30	207
1940			
January	5.40	20.70	200
February	5.50	21.80	203
March	5.70	21.40	203
April	5.80	20.40	200
May 3	5.92	20.50	
May 14	6.23	20.02	
May 28	6.50	20.36	191
June	6.50	22.80	192
December 1	6.50	26.16	196

[1] Average of selling rates per month, unless day is indicated.
[2] Wholesale prices in Lima.
Source: Banco Central de Reserva del Peru, *Bulletin*, various issues.

sell to each of their clients his customary share of the market.[1]

A similar mechanism, which had been set up without the cooperation of exporters in August 1939, had proven unsuccessful. Clearly, no voluntary arrangements designed to stabilize the sol could succeed without the cooperation of the latter. It is therefore interesting to discuss what might have made controls acceptable to exporters in May 1940.

In 1939, almost 30% of Peruvian exports were sold in the sterling area.[2] The appreciation of the sol in relation to the pound sterling tended to depress sol returns to Peruvian exporters to a significant extent. One may surmise that therefore affected exporters did not look with disfavor upon a depreciation of the sol in relation to the dollar, for such

[1] See Camara de Comercio de Lima, *Memoria*, 1940, pp. 52-55, and Banco Central de Reserva del Peru, *Bulletin*, May 1940 and August 1940, for the control mechanism set up in May 1940 and also for the controls attempted in late 1939, mentioned below.

[2] Calculated from information on the destination of exports in *Anuario del Comercio Exterior del Peru*, 1939.

depreciation tended to keep the sol from appreciating in relation to the pound sterling. However, Table I shows that following the May stabilization of the sol in relation to the dollar, the pound sterling began to appreciate. From 20.36 it rose to 26.16, a rate corresponding exactly to the official dollar sterling rate. This appreciation was the result of the intervention in the market by British and Peruvian authorities in pursuance to an agreement pegging the pound at 26.16.[3] Peruvian exporters must have known about the agreement at the time they joined in the voluntary control mechanism. The effect of the agreement with the British authorities and of the May stabilization was, actually, as shown by Table I, that the sol depreciated slightly against the pound sterling between August 1939 and December 1940. Also, as our table shows, average sol export prices remained slightly above those of August 1939. Hence, at the time the exporters agreed to the voluntary control mechanism, fears that the vicissitudes of the pound sterling might subject them to substantial losses must have been minor, if they had not disappeared.

However, once the problem of the pound sterling was solved, there still remained that of markets. These were seriously endangered by the war in Europe. Exporters faced the likelihood of considerable losses if unable to sell an appreciable proportion of their products. Depreciation must have appeared as one way of at least diminishing such losses. However, at the time of the stabilization of the dollar sol rate, this problem was solved in a manner satisfactory at least to the exporters. A new law authorized the Central Bank to rediscount two-year promises to pay against agricultural export commodities. The state was to assume any losses that might result from such operations.[4]

Inflation. Table II indicates that the quantity of payment media rose by 838 million soles, or by 269% between 1940 and 1945. A conscious easy money policy and huge government deficits largely financed by the Central Bank were the principal factors responsible for this expansion. The inflow of foreign exchange, with the exception of 1942, played a minor role.

---

[3] See Banco Central de Reserva del Peru, *Bulletin*, August 1940 and September 1940.

[4] Law 9154, June 1, 1940.

TABLE II

PAYMENT MEDIA — 1939-1945

In Million Soles

End of Year	*Total Payment Media*	*Change in Total*	*% Change Central Bk. Origin*[1]	*% Change Comm. Bk. Origin*[2]	*% Change For. Exch. Origin*[3]
1940	388	+ 72	31	58	11
1941	488	+100	49	41	10
1942	668	+180	47	4	49
1943	845	+177	39	37	24
1944	1,024	+179	62	39	— 1
1945	1,154	+130	83	2	15

[1] Central Bank demand obligations—Central Bank gold and foreign exchange holdings. Treasury money creation is included, for we have not deducted silver and other coins.

[2] Commercial bank demand obligations (excluding interbank deposits)—Deposits at Central Bank, cash in vaults, and foreign exchange holdings from which short-term obligations abroad have been deducted.

[3] Foreign exchange and gold held by Central Bank and commercial banks—Short term obligations abroad.

The method of calculation follows that of Robert Triffin, *Monetary and Banking Reform in Paraguay*, Board of Governors of the Federal Reserve System, Washington, 1946, p. 44.

The Peruvian Central Bank made similar calculations, based on Triffin's method. See Banco Central de Reserva del Peru, *Bulletin*, various issues. Our calculations differ slightly from those of the Central Bank in that: 1. We have considered foreign exchange demand deposits as payment media. 2. The foreign exchange deposit liabilities of Peruvian banks have not been deducted from their exchange assets. The former usually exceed the latter by a considerable amount, so that our calculations increase the amount of money of foreign exchange origin.

Source: Calculated from data in Banco Central de Reserva del Peru, *Bulletin*, various issues.

Causes. Shortly after the May stabilization of the sol, on August 1, 1940, the Central Bank lowered the rediscount rate, declaring that monetary expansion was desirable in order to stimulate domestic production and make the country less dependent upon imports and insecure export markets. The banks followed step, and the state's Mortgage Bank decided to issue bonds paying 6% interest instead of 7%. Soon thereafter, the issuance of 200 million soles of government bonds for public works was authorized. The bonds could be sold to the Central Bank at 95% of their nominal value.[5]

[5] Law 1987, October 7, 1940; Law 9929, January 28, 1941. Also see Banco Central de Reserva del Peru, *Bulletin*, August 1940; and Emilio Barreto, "La Politica Financiera del Peru," *Comercio*, June 1, 1941.

These steps, together with the law practically guaranteeing exporters against losses, were designed to maintain and stimulate economic activity, regardless of whether or not all exports could be sold abroad. It was evidently believed that the exchange rate at which the sol was stabilized was so unfavorable that there was considerable room for monetary expansion even though export and foreign exchange returns were low.

Fortunately, difficulties in placing Peruvian exports were only temporary. In 1941, Latin America and Japan largely took the place Europe had occupied as buyer of Peru's exports. Following 1941, and throughout the rest of the war period, pursuant to a series of special agreements, the United States guaranteed the prices and sales of Peruvian export products.[6] The country's payments position improved to such an extent that, as shown by Table II, in 1942 a foreign exchange inflow was responsible for 49% of the increase in the monetary supply during that year. The table, however, also shows that during all the war years but 1942 the rise in payment media was largely of domestic origin.

The primary responsibility of this increase must be placed upon the rapidly rising public debt, financed predominantly through Central Bank money creation. In addition to the above-mentioned bond issue of 200 million soles, that could be sold to the Central Bank at 95% of nominal value, two further laws sanctioned the extension of Central Bank credit to the government of up to 300 million soles for national defense. The government, furthermore, was able to use amply its right to discount Treasury bills whose amount, according to a law passed at the beginning of 1938, was only to be limited by agreements with the Central Bank. To this must be added food subsidies which began in 1944.[7] The increase in the public debt which these provisions made possible is shown by Table III.

Most of the increase in the public debt was absorbed by the

---

[6] See *Anuario del Comercio Exterior del Peru*, various issues, and Camara de Comercio de Lima, *Monthly Bulletin*, July 1941, October 1941, September 1941, April 1942, May 1942, and August 1943.

[7] Laws 9312 and 9713 of respectively February 10, 1941, and January 5, 1943, authorized the 300 million soles defense credit. The 1938 law referred to above is law 8612, January 1, 1938. Food subsidies were authorized by law 9047, January 13, 1940.

TABLE III

BANK CREDIT AND THE PUBLIC DEBT — 1941-1945

In Million Soles

	1941	*1942*	*1943*	*1944*	*1945*
Central Bank	52	84	77	107	127
Ntl. Def.[1]	44	62	44	59	53
Food Subs.[2]	—	—	—	22	40
State Banks[3]	—	17	—12	— 4	— 5
Other[4]	8	5	45	30	39
Commercial Banks	34	34	127	136	79
Government	— 3	12	23	46	5
Other[5]	37	20	104	89	86
Rise in bank held govt. debt	49	79	112	157	123
Total rise in national debt	68	89	112	214	111
Rise in sol reserves of com. banks	13	93	68	65	53

[1] Laws 9312, 9713.

[2] Law 9047.

[3] The *Banco Agricola*, *Banco Industrial*, and *Banco Minero*.

[4] Includes direct discounts and rediscounts, from member and other banks, of Treasury bills authorized by a variety of laws. The largest amount is attributable to law 8612. The item other also includes some government obligations.

[5] Includes some mortgage bonds and shares.

Source: Data on the Central Bank portfolio from Banco Central de Reserva del Peru, *Bulletin*, various issues. Data on portfolio of commercial banks from Superintendencia de Bancos del Peru, *Memoria*, 1940-1945. Data on the public debt from United Nations, *Public Finance Information Papers, Peru*, p. 62.

Central Bank, thus resulting in the creation of new money. Commercial banks absorbed a minor proportion of the public debt. Their sol reserves were amply increased by the Central Bank's money creation, so that they were able to give substantial credits to others than the government. As reserve requirements against demand deposits were 15%, they could have extended still more credit. Taking Central Bank and commercial bank credit together, government borrowing from banks still absorbed by far more than half of the total bank credit during each of the years considered.[8]

---

[8] Sol reserves of the banks did not rise by an amount equal to Central Bank credit because bank note circulation increased, the government kept deposits at the Central Bank, and some of the loans were in foreign exchange.

Prices. The monetary expansion led to considerable price increases, notwithstanding price controls.[9] The rise in prices is roughly indicated by Table IV, which is based on official Peruvian price indices for Lima. Inasmuch as there were price controls, it is likely that prices of all but export goods actually increased by more than this table indicates. Prices

TABLE IV

PRICES IN LIMA — 1939-1945

1939 = 100[1]

Year	Wholesale Prices				Cost of Living Index	U. S. Wholesale Index
	Export Goods	Import Goods	Domestic Goods	General		
1939	100	100	100	100	100	100
1940	109	126	104	115	108	102
1941	116	156	116	138	117	113
1942	141	206	131	179	132	127
1943	157	240	157	196	145	133
1944	170	236	173	201	165	135
1945	174	232	193	211	184	137

[1] Peruvian indices have been converted from 1934-1936 = 100 to 1939 = 100. The U. S. index has been converted from 1948 = 100 to 1939 = 100.

Source: Peruvian indices have been taken from Banco Central de Reserva del Peru, *Bulletin*, various issues. The U. S. index from United Nations, *Statistical Yearbook*, 1952, p. 391.

of export goods reflected foreign prices and the exchange rate. The latter remained stable following 1940. Import prices, on the other hand, on the average increased more than foreign supply prices. This can be deduced from the fact that the sol import price index rose very much more than the United States wholesale price index, and fluctuated in 1944 and 1945 in a direction opposite to that of the United States index. The United States supplied from 50 to 60 percent of Peruvian imports during the war. Even if allowance is made for the fact that prices of some of Peru's suppliers increased by more than United States prices, the same conclusion is reached. An import supply price index, constructed on the basis of price levels of Peru's principal suppliers and weighted by their share in Peru's imports, gives us an average increase in supply prices of 50% between 1940 and 1944. The Peruvian sol import price index, on the other hand, rose by 90% during

[9] Controls were based on laws 8951 and 8952, both of September 3, 1939. Also see Decrees of May 31, 1940, and August 27, 1943.

this period.[10] Hence, price changes abroad were not primarily responsible for the increase in Peruvian prices during World War II. The cause was of domestic origin, namely, excessive monetary expansion.

Could Monetary Expansion Have Been Slowed Down? How could brakes have been applied to the expansion? Taking fiscal policy as given, only two steps suggest themselves. First, appreciation of the sol. Second, the use of the usual monetary weapons: the rediscount rate, open market operations, and changes in reserve requirements.

The question as to whether an appreciation of the sol would have been advisable must be answered in the negative. However, this conclusion depends on the effects an appreciation would have had upon the balance of payment, and we shall consider it when discussing the foreign exchange market at the end of the paper. At this point, we shall confine ourselves to the other monetary weapons.

An increase in the rediscount rate would not have altered the situation. It suffices to point out that commercial banks did not rediscount any commercial paper at the Central Bank during those years. As Table III indicates, their reserves increased more than sufficiently to permit them to expand credit to the extent that they desired.[11] Open market operations were not likely to prove successful. It might perhaps have been possible to sell an appreciable quantity of government obligations held by the Central Bank to the public by lowering their prices. It was, however, the announced policy of the government, with which the Central Bank concurred. to lower the rate of interest on government obligations in order to save the Treasury some money. Prices of government bonds did rise considerably during the war. Their index increased by 282% from 1939 to 1944.[12] In view of this policy, the possibility of open market operations can be discounted, even if they had been possible otherwise.

This leaves us with an increase in reserve requirements as a possible anti-inflationary step. However, there was no statutory provision permitting such changes. Undoubtedly,

---

[10] See footnote 14 and the discussion pertaining to it.

[11] Banks could also have rediscounted Treasury bills. These were rediscountable at the Central Bank at the preferential rate of 1% according to law 8612.

[12] See Banco Central de Reserva del Peru, *Bulletin*, July 1945.

a sufficient increase in the requirements could have inhibited the expansion of commercial bank credit. It should not be forgotten, however, that in that case the Central Bank money creation would have been greater, inasmuch as the government would have sold a still greater proportion of its obligations to that institution.

We therefore conclude that, given the fiscal deficits and the policy of keeping interest rates low on government obligations, nothing could have been done to restrain the monetary expansion.

National Income. The monetary inflation would not have resulted in as large an increase in prices had output risen to a greater extent. Table V indicates a rise in Gross National Product, at constant prices, of about 30% between 1940 and

TABLE V

PERUVIAN GROSS NATIONAL PRODUCT — 1940-1944
In Million Soles

	1940	*1942*	*1943*	*1944*
GNP	2,439	2,951	3,240	3,829
Index of GNP deflated[1]	100	121	117	129

[1] Deflated by the index of wholesale prices in Lima.

Source: For 1940 estimate see my doctoral dissertation, *Peruvian Foreign Exchanges*, University of Wisconsin Library, 1953, Appendix. For the other years, see Banco Central de Reserva del Peru, *Renta Nacional del Peru*, 1942-1949, Lima, 1951, pp. 53, 56.

1944. Inasmuch as there were price controls, price indices probably underestimate the extent to which prices increased. It is therefore likely that real product actually rose by less than 30%. Moreover, part of the increase in real product must be attributed to an improvement in the terms of trade. In any event, it seems safe to estimate a rise of 30% as a maximum increase in the quantity of goods and services purchased at home between 1940 and 1944.

The Demand for Imports. The demand for imports increased during the war. This was caused by the rise in the quantity of payment media. A rough calculation of the extent to which the increasing supply of money was likely to translate itself into an active demand for imports once these could be obtained from abroad will here be undertaken. This can, of course, be only a rude estimate. Its purpose is to show the

approximate magnitude of the increase to be expected, so that we may be in a position to judge the adequacy of the exchange rate.

If the country's money supply is calculated in foreign exchange in order to eliminate exchange rate variations, and neglecting momentarily controls or supply restriction of any sort, the foreign exchange value of imports will tend to increase by about as much as the quantity of money if certain conditions are satisfied. Any potential increase in the money supply will, of course, not realize itself to the extent that imports increase. The increase in the quantity of payment media is here taken as a cause. The conditions that have to be met are:[13]

1. The real domestic output purchased at home remains constant.
2. Capital exports or other remittances abroad whose purpose is not the payment of imports remain constant.
3. The amount of imports directly purchased with loans or grants remain constant.
4. The price level remains constant.
5. There is no change in income velocity.
6. Transaction payments, including those for purely financial payments, remain constant.

These conditions can be explained briefly.

1. If domestic output purchased at home increases, without a rise in prices, the amount of money needed to finance the production and sale of this output also increases. To that extent, a rise in the monetary supply will not lead to an increase in imports.

If foreign exchange receipts rise because export output has increased, other domestic output remaining constant, foreign exchange receipts and the money supply rise, and the additional money, everything else remaining equal, is spent for imports. If foreign exchange reserves increase because prices abroad have risen, the money supply increases, and, again, other things remaining equal, imports will increase by that amount.

2. If more money is sent abroad for other purposes than the purchase of imports, imports do not rise to the extent that this is the case.

---

[13] Changes in income distribution need not be mentioned separately. These are only relevant if they produce changes in real output or velocity. These latter are two of our conditions.

3. If more imports are financed with loans, grants, or other additional receipts from abroad not already mentioned, the total value of imports would rise by more than the money supply, if the money with which the goods are bought has never become a part of the domestic money supply.

4. If domestic prices increase, more money is needed to finance transactions. Here no controls are assumed, so that, neglecting tariffs, the price level, expressed in foreign exchange, could not rise above that of the country's trade partners. Tariffs can cause the price level to increase beyond this limit. For Peru, an atomistic buyer and seller, only import tariffs are relevant.

5. A fall in velocity is analogous to a fall in the supply of money in its effect on expenditures. An increase or decrease in purchases of liquid and other foreign assets than imports represents no change in velocity. These are considered under 2 above.

6. Just as an increase in the price level, assuming constant output, or the production and sale of more domestic goods at

TABLE VI

IMPORTS AND MONEY SUPPLY — 1937-1945

In Million Dollars

	1937	*1939*	*1940*	*1941*	*1942*	*1943*	*1944*	*1945*
Food	10	7	7	7	8	9	18	18
39$[1]	9	7	7	6	5	6	12	12
Textiles[2]	9	7	8	7	9	13	10	10
39$[1]	6	7	8	6	6	9	7	7
Drugs[3]	6	7	8	10	10	14	12	10
39$[1]	6	7	8	9	8	11	10	8
Machines, Vehicles	12	8	10	11	8	10	12	16
39$[1]	12	8	10	11	8	9	12	14
Metals, Manufactures	9	7	8	8	5	8	8	12
39$[1]	8	7	8	7	5	7	7	11
% of Total Imports	78	73	77	76	78	77	77	78
Total Imports	59	50	52	56	51	69	84	84
Money Supply	69	63	63	75	103	130	157	177

[1] Adjusted to 1939 dollars on basis of U. S. wholesale price index of the U. S. Bureau of Labor Statistics for subgroup indicated.

[2] Includes leather and leather goods, which do not amount to much.

[3] Includes other chemical and biological substances than drugs.

Source: Ministerio de Hacienda y Comercio, *Anuario del Comercio Exterior del Peru*, various issues. For source of money supply, here converted into U. S. dollars at the average exchange rate for the year, see Table II.

constant prices, requires more money, an increase in financial transactions, or in the number of intermediaries through which goods pass, means that more money is needed.

Now, Table VI shows that between the end of 1940 and that of 1944, the Peruvian monetary supply, expressed in dollars, increased by 94 million. If all of the above conditions had been met, this increase could not have taken place. Rather, in 1944 imports would have amounted to 94 million dollars more than they did. Why did imports not increase that much? In order to explain this, we must first drop the basic assumption made throughout the preceding, namely, that imports could be freely obtained. This, as will be seen below, was not possible during the war years. Consequently, condition 4 above must be modified. The domestic price level can well increase beyond that of the country's trade partners when the demand for imports cannot be satisfied. Below it will be seen that this was the case. Consequently, as shown by Table IV, the Peruvian wholesale price index was able to rise by 75% between the end of 1940 and that of 1944. This means that 75% more money was required to finance transactions. This amounts to 47 million dollars.

Secondly, Table VII shows that velocity declined by about 20%. Therefore, expenditures did not rise by 94 million dollars, but only by 63 million dollars. Deducting the 47 million additional dollars required for transactions at higher prices from these 63 million dollars, we are left with 16 million unexplained dollars. If we accept the national income estimates discussed above, and allow for a maximum increase in real output domestically purchased of about 30%, these 16 million dollars would be more than accounted for.

The absorption of the greater money supply primarily through higher prices and lower velocity could not be expected to continue to the same extent as soon as supplies could again be freely obtained abroad. Without a depreciation of the sol or controls, the Peruvian price level had to fall, unless prices abroad rose sufficiently to catch up with Peruvian prices. On the basis of the foreign price indices the Peruvian price level would have tended to fall by roughly 14%, or to about 50% above that of 1940. This estimate has been reached by weighting the increases in the wholesale price indices for finished goods of the United States and Great Britain, and the general wholesale price index of Chile, with the percentage of imports

coming from the United States, the sterling area, and Latin America, respectively.[14]

Velocity, which declined by 20%, was likely to increase upon the war's end to its prewar level. It can be surmised that the main reason why velocity fell is that, just as in the United States, the purchase of many durable goods had to be postponed. However, other conditions permitting, postponed purchases were likely to be made as soon as supplies abroad again became available. Table VII shows that actually velocity increased again, even beyond its prewar level, soon after the war ended.

We can calculate roughly the likely increase in the demand for imports, once supply conditions abroad permitted their purchase, on the basis of the increase in the money supply from 1940 to 1944. We are assuming neither depreciation nor exchange controls. Furthermore, we must assume that no capital exports, decreasing the quantity of money, take place. We also assume that the necessary fall in the Peruvian price level can take place, and does take place without a contraction in the supply of money. In other words, the supply of money does not decrease as a result of a contraction of loans. An increase of imports, other things remaining equal, will, of course, contract this supply.[15]

Under such conditions the increase in imports would have been about 40 to 50 million dollars above those purchased in 1944. The higher price level, higher as compared with 1940

---

[14] Peru's imports from Latin America come predominantly from Argentina. However, the Chilean index has been used, in order to allow for greater price increases in other South American countries than Argentina. On the trade pattern see *Anuario del Comercio Exterior del Peru*, various issues.

[15] The fall in prices would probably not have been as difficult as might at first be thought. Due to the inflationary conditions, profits of all, especially those of imports, and excepting those of exporters, can be surmised to have been rather high. The Peruvian wholesale import price index had risen by 90%, while our weighted foreign price index had increased by only 50%, and the total average wholesale Peruvian index by 75%. Domestic prices of imports would therefore have fallen by more than those of other goods, while costs of domestic producers would have declined, if they imported commodities for production purposes. Exporters' prices would not have declined while their costs would have tended to fall. It is conceivable that under such circumstances, assuming that foreign exchange supplies were adequate, the pressure for depreciation might have been resisted.

TABLE VII

VELOCITY OF CIRCULATION[1] — 1937-1948

Year	*V*	*Year*	*V*	*Year*	*V*
1937	21.6	1941	19.6	1945	16.9
1938	22.4	1942	18.9	1846	21.9
1939	21.0	1943	18.2	1947	21.7
1940	21.3	1944	17.4	1948	23.3

[1] Transactions velocity.

Source: Calculated from monthly velocity data based on average of daily sol demand deposits of commercial banks and the monthly amount paid from these deposits in Banco Central de Reserva del Peru, *Bulletin*, various issues.

by 50%, would have absorbed 32 million dollars of the increased money supply, and 18 million would have been absorbed by the increase of 30% in real output purchased domestically for which we have allowed above. This figure of 40 to 50 million dollars is, of course, only intended to give an impression of the magnitude of the increase in the demand for foreign exchange for imports to be expected once foreign supplies became freely available, if other factors remained the same, and adequate supplies of exchange had been available.

The Foreign Exchange Market. We can now turn to a summary of the situation on the foreign exchange market and to an evaluation of the adequacy of the exchange rate. An appreciation of the sol, notwithstanding the fact that a substantial foreign exchange influx did take place during part of the war years, would not have been advisable, and as the war approached its end, the future of the sol could not be viewed optimistically.

During 1940 the sol faced difficulties. At the beginning of this article, it was pointed out that it was feared that it would be difficult to sell part of Peru's agricultural exports, and that such difficulties appeared at the beginning of 1940. The sol fell rapidly, until it was stabilized in May 1940, with the aid of a voluntary control mechanism in which the exporters agreed to deliver exchange at the "official" rate, and the banks to ration available exchange at that rate.

During the months following the May stabilization an exchange influx took place, and the banks did not have to ration foreign exchange. The depreciation had apparently been excessive as of that time. At the end of 1940, however, some diffi-

culties reappeared on the exchange market. Table VIII below shows that in 1940 the value of exports was unusually low. On the other hand, the expansion of payment media increased the demand for imports. At the end of 1940, the demand for imports was at its seasonal Christmas height, and the banks had to ration exchange. During the last quarter of 1940, and the first month of 1941, appreciable exchange reserves were lost.[16] Hence, in the light of the situation at the end of 1940, it cannot be said that the May stabilization had taken place at an excessively low rate.

Table VIII shows that during 1941 the value of exports rose substantially. That of imports, however, impelled by the rising supply of payment media, also increased, so that the year ended with only a small rise in the country's foreign exchange reserves, though short supplies already restricted imports during that year. In view of the rising value of exports, it might have been maintained that the sol should have been appreciated during 1941, and that the 1940 depreciation was excessive.[17] However, such a view neglects the effects of the rising supply of payment media upon the demand for imports. Had the former not continued to increase, appreciation might have been in order, and the 1940 depreciation excessive. The money supply, however, did increase for causes which we have seen to have been of domestic origin, stimulating imports. Hence, we must conclude that the exchange rate was acceptable, from the point of view of the balance of payments without controls, during 1941.

Turning to 1942 and 1943, the question of the adequacy of the exchange rate becomes more complex. Table VIII shows a considerable rise in foreign exchange reserves during those years. Under these circumstances, the question arises whether an appreciation of the sol might not have significantly lessened inflationary pressures. It it believed that the answer must be in the negative for the following reasons.

Appreciation would not have slowed down the monetary expansion to a degree that warrants notice. This is because, as

[16] See Banco Central de Reserva del Peru, *Bulletin*, July 1940, and February 1941.

[17] This was actually the point of view of many at that time. See, for example, the interview with the director of the Central Bank's economic research section, Oscar F. Arrús, *Revista de Economia y Finanzas*, Lima, January 1941, p. 66.

TABLE VIII

PERUVIAN BALANCE OF PAYMENTS — 1937-1945

In Million Dollars[1]

Year	Imports[3]	Exports[4]	Interest Dividends Paid Abr.	Capital + is inflow — is outflow Long[5]	Capital + is inflow — is outflow Short	Gold and For. Exch. Reserves Change[6]
1937[2]	59	92				
1939	50	73	21		— 1	+ 3
1940	52	66	16	+13	— 1	— 1
1941	56	79	16		— 1	+ 2
1942	51	85	16	+ 2	— 2	+15
1943	69	89	16	+ 5	— 2	+ 6
1944	84	102	21	+15	—10	— 1
1945	94	110	20	+15	—12	+ 1

[1] Original data have been converted into dollars at the average yearly exchange rate for the year indicated.

[2] Only imports and exports available.

[3] C.I.F.

[4] F.O.B.

[5] Includes Lend-Lease and some other government induced capital flows.

[6] Negative sign means decrease, positive sign means increase.

The above figures on short term capital tend to be roughly confirmed by data on short term United States bank liabilities to Peruvians, which are unfortunately not available before 1942. These liabilities increased by 6.3, 10.3, and 16.2 million dollars in respectively 1943, 1944, and 1945. See Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin.*

Source: Banco Central de Reserva del Peru, Balanza de Operaciones Internacionales del Peru, 1938-1947, Lima, 1948, pp. 38-42.

discussed earlier, the increase in payment media during the war years was caused primarily by domestic factors. A few mathematical calculations will show that even in 1942 appreciation would not have lessened inflationary pressures. Table II has shown that in 1942 a greater percentage than during any other year, namely 49%, of a rise in the money supply, which during that year amounted to 180 million soles, was attributable to the influx of foreign exchange. Table IV has shown that the export price index rose by 36% between 1939 and the end of 1942. The cost of living index, our best approximation to the rise in costs, increased by 13% over these years. An appreciation of 30% is the maximum which, under these circumstances, could have been considered if exporters were not to suffer considerable losses. However, an appreciation of 30%

would only have lessened the influx of exchange, expressed in domestic currency, by 27 million soles, while the money supply did increase by 180 million soles. Inasmuch as there is no reason to assume that the demand for bank credit would have been lessened by an appreciation of the sol, and banks had considerable excess reserves, the supply of money would at best have risen by 153 million soles rather than by 180 million soles.[18] This would certainly have been an insignificant difference. We can therefore conclude that appreciation would not have softened the monetary inflation significantly.

There is no reason to believe that appreciation of the sol would have led to a fall of import prices. Supply restrictions abroad limited imports. Without such restrictions the latter would have amounted to considerably more. This pressure of demand caused import prices to rise considerably above their supply prices abroad. Consequently, appreciation would only have raised the profits of imports, at the expense of those of exporters, without diminishing inflationary pressures.

Inasmuch as appreciation would not have changed the value of imports in foreign exchange, it follows that the demand for foreign exchange to pay for imports would have been the same had the sol been appreciated. It does not follow that the demand for foreign exchange for all purposes would necessarily have remained the same. Payments for interest and dividends are preponderantly payments made by exporting firms. With an appreciated sol, exporters would have been forced to devote a larger proportion of their foreign exchange receipts to the payment of domestic costs, lowering their profits. Hence, the demand for foreign exchange for the payment of dividends might well have declined.[19] Some of the remittances in payment of interest and dividends, however, are proceeds derived from domestic transactions, such as those of the British railroad. Profits here are largely a function of domestic activity, which, we are assuming, would not have been affected by the

---

[18] Bank reserves in domestic currency rose by 93 million soles during 1942, while money creation through commercial bank credit amounted to 65 million soles. Reserve requirements were 15%. See Table II.

[19] The foreign exchange prices of Peruvian exports can be taken as given. The demand for almost all the value of Peruvian exports is practically perfectly elastic. See Rolf Hayn, "Cyclical Exchange Rate Policy and Real Income," *Inter-American Economic Affairs*, Summer 1954, pp. 62, 63.

appreciation. Here, appreciation would have caused an increase in the quantity of foreign exchange demanded for the remittance of interest and dividends. Inasmuch as remittances from export proceeds exceed those made from profits obtained through domestic activities, appreciation would probably have led to a fall in the demand for foreign exchange rather than an increase.

Table VIII shows that interest and dividend payments amounted to 15 to 20 million dollars during the war years. Assuming again a 30% appreciation, and allowing for the fact that remittances of some firms would increase, the conclusion appears reasonable that remittances would have declined by no more than 5 million dollars. Hence, though appreciation would not have affected the demand for imports, we conclude that the demand for foreign exchange would have declined slightly, unless capital flows offset this tendency. Such flows will be discussed later.

Looking at the issue from the point of view of the supply of foreign exchange, we come to the conclusion that, again excepting capital flows, appreciation might have led to some decrease, though not a large one, in the supply of foreign exchange originating in exports. In our discussion on exports we concluded that, in the race between costs and export prices, the latter were winning until 1944. Hence, some appreciation would, until 1944, not have led to a fall in exports, unless by lowering export prices in domestic currency in relation to the prices of other domestically produced goods, such appreciation led to a greater shift in resources away from export production than did take place. Table IV has shown that on the average prices of domestically produced goods lagged behind the rise in the export price index, so that appreciation would have made a resource shift to the production of the former goods more attractive. Hence, though the possibilities of raising domestic output at the expense of export production were, as will be remembered, quite limited because of the economy's structure and the impossibility of securing from abroad the type of imports that would have been required, appreciation might well have led to some further restriction of export output. Appreciation even without causing exporters to produce at a loss, therefore would probably have resulted in some fall in the supply of foreign exchange.

Turning to capital flows, we find a powerful argument

against appreciation. Certainly, a rise in the foreign price of the sol would not have stimulated the flow of foreign capital into Peru, which, as shown by Table VIII, was negligibble in any event. However, appreciation of the sol was quite likely to stimulate an outflow of funds. Table VIII shows that the outflow of short-term capital was negligible during the years under discussion. This shows that exporters abided by the voluntary control mechanism to which they had agreed in May 1940. It is questionable whether exporters would have continued this cooperation had the sol been appreciated. Considerable misgivings as to the future value of the sol, which, as will be seen below, appeared in 1944, would probably have emerged sooner. Certainly, an appreciation would have made a depreciation seem more likely. Hence, it is probable that foreign exchange receipts would have been withheld from the market at the official rate, while exporters as well as others tried to build up their funds abroad. Considering the liquidity of the economy, the capital outflow could have been considerable. It might well have absorbed the rise of about 25 million dollars in foreign exchange reserves which, as Table VIII shows, took place during these years.[20] With the aid of controls, the outflow might have been stopped. However, it seems unlikely that controls would have been established in order to make appreciation possible. It should be remembered that in 1940 the same government that was in power in 1943 permitted a strong depreciation of the sol in order to obtain the exporters' cooperation to a voluntary control scheme. Certainly, if appreciation would have been effective with controls, such a step should not have been taken unless considerable other benefits would have been obtained.

Were there such benefits? It is believed that the foregoing considerations clearly indicate a negative answer. Neglecting capital movements, the demand for foreign exchange might have fallen slightly. On the other hand, the supply was

---

[20] A considerable outflow would have lessened inflationary pressures, but to accomplish this objective in that manner would have been unadvisable.

If velocity had risen in 1943 to the 1940 level, expenditures would have risen by 15 million dollars. Time deposits had increased by about 23 million dollars over these years. A capital outflow could thus easily have absorbed the increase of 25 million dollars in the country's foreign exchange reserves. See Tables VI and VII.

also likely to decline somewhat. It is impossible to say whether the net outcome would have been a gain or loss of 2 or 3 million dollars yearly. One must therefore operate on the assumption that there would neither have been a net gain nor a net loss. Finally, the inflationary pressures would not have been softened significantly, for neither would imports have risen, depressing the prices of imported commodities, nor would the supply of money have risen appreciably less. We therefore conclude that appreciation of the sol would not have been advisable during either 1942 or 1943.

Following 1943, any appreciation was completely out of the question. On the contrary, the sol's position weakened at the end of 1944, as the immediate result of a capital outflow. Table VIII shows that this amounted to about 10 million dollars. In January 1945, exchange and import controls were introduced. These, as well as the immediate events leading to their establishment, have to be discussed elsewhere. Here we shall limit ourselves to pointing out those factors which by 1944 justified fears as to the future of the sol.

Table VIII shows that foreign exchange reserves increased by only about 26 million dollars during the war years. On the other hand, it was seen that the demand for imports was likely to increase by as much as 40 to 50 million dollars as soon as conditions abroad permitted their purchase. Hence, unless the supply of foreign exchange increased sufficiently, it could be predicted that soon after the war's end, the demand for foreign exchange would be excessive, and that without controls the sol would have to fall. On the supply side, we do not find the situation any more encouraging. It was seen that in 1944 the cost inflation was beginning to menace exporters with losses. Unless prices rose sufficiently, a further decline of export output was likely if the same exchange rate was maintained. It is well known that many expected prices to decline rather than to increase upon the war's end. Hence, there was no reason to assume that the supply of exchange would rise. Rather, a decline of export output and of the foreign exchange supply seemed quite possible. Consequently, in view of the considerable increase in imports that had to be expected, and the relatively small rise in foreign exchange reserves during the war, the future of the sol could not be viewed optimistically as the war approached its end.

U.S. Government Assistance To The Underdeveloped Countries, 1945-1953

By J. Fred Rippy*

I

Returning from an official mission to South America in 1953, Milton Eisenhower reported to his brother, the President of the United States, that rather serious misunderstanding of this country had developed in lands to the south. "A great deal of this misunderstanding is a natural consequence of our assistance programs," Mr. Eisenhower declared. Aid to "other areas came precisely at the time that need for foreign capital was growing rapidly in Latin America, and loans to them, though substantial, did not fully satisfy their aspirations." Latin Americans have concluded that "the United States considers other areas of the world to be more important to its future than the countries of Latin America." Overestimating the resources of their big neighbor, they have felt that the United States had "such vast riches that it could, if it wished, have made substantial funds for development available to them at a time when it was providing billions of dollars to other parts of the world." What Latin Americans desired—and still desire—was primarily "not financial *grants* but *loans*—loans . . . to satisfy their driving demands for a broad and immediate development of their economies." "They view with skepticism all explanations of our need to reduce our own public expenditures," reported Mr. Eisenhower. "To them our financial capacity appears unlimited." Although "some condemn foreign investment as an actual or potential evil and . . . some adopt practices" that tend to prevent the "entrance of foreign capital, *all*"—quite inconsistently—"strongly insist that a greater volume of public and private capital from abroad is needed if they are to meet their just aspirations."[1]

---

* Professor of History, University of Chicago.

[1] Milton S. Eisenhower, *Report to the President* (Washington, D. C., 1953), pp. 7-8. The report was dated November 18, 1953. The mission arrived in South America late in June and remained there until toward the end of July.

Appearing before the United States Senate Committee on Banking and Currency early in 1954, Chester R. Dewey of the Grace National Bank asserted: "Latin Americans are aggrieved because they feel that during the war they sold us their strategic war materials at prices we controlled and at prices they considered unreasonably low. Then when the war was over we turned our attentions and affections to Europe, pouring out money with a lavish hand, while at the same time we sold Latin America manufactured goods they needed at constantly increasing prices." Latin Americans resist all explanations. "No amount of . . . calculations showing" that prices for foods and raw materials produced by Latin America rose more rapidly than prices for manufactured goods produced by the United States "will convince them that they have not been mistreated," declared Mr. Dewey.[2]

Such are said to be Latin America's grievances. Prices for what they have to sell are too low. Prices for what they must buy are too high. The United States is more interested in other countries and regions than in Latin America, and more disposed to promote their economic development than Latin America's. It is time to look at the facts, and some of them will now be examined. The trend of commodity prices and assistance by the United States Government to war-harried and beleaguered Europe will not be dealt with here, however. Attention will be confined to a comparative analysis of aid by the United States Government to the three main economically retarded regions—Latin America, Africa, and Asia—during the eight and one-half years immediately following the last days of World War II.[3]

---

[2] Senate Committee on Banking and Currency, *Hearings*, 83 Cong., 2 Sess. (1954): "Study of Export-Import Bank and World Bank," pp. 250-51.

[3] Japan, China, Formosa, and Korea will be set aside because very critical conditions made them very exceptional cases, and Australia and New Zealand will be excluded because they are situated in Oceania and are not strictly a part of Asia. Indochina and the Philippine Republic might also be omitted because conditions in both of them were peculiarly critical, but they will be included as a sort of concession to Latin America's reported complaints. Moreover, the inspection will be limited *solely* to *direct* aid. It will not include contributions, *indirect* assistance, through the United Nations, the Organization of American States, the International Children's Fund, the International Bank, and the International Monetary Fund, contributions aggregating more than $3,518.5 million,

Loans and other credits extended to Latin America by the United States Government from July 1, 1945, through the year 1953 aggregated well over a billion dollars. Grants during the same period amounted to more than $401 million. The major recipients of this government aid were Argentina, Brazil, Chile, and Mexico; but every country in the region received some grants and all except the Dominican Republic and Guatemala obtained loans and other credits. Assistance to Colombia amounted to more than $59.5 million and aid to Bolivia exceeded $41.6 million. Peru received $30.7 million; Cuba, more than $23.2; Ecuador, nearly $22.8; Venezuela, over $15; Uruguay, in excess of $13 million. The Dominican Republic, which benefited least from this government assistance, obtained a grant of considerably more than a million during the period. Brazil's total was no less than $468.4 million; Mexico's, more than $287.1 million; Chile's, $125.8 million; Argentina's, above $100 million.

Loans and other credits extended by the government of the United States to Asia—excluding Japan, Formosa, Korea, and China, where policy was determined by intense crisis, and omitting Australia and New Zealand because they are situated in Oceania—amounted to a little less than $721 million, not quite three-fourths of the aggregate for Latin America, during the years running from July 1, 1945, through December 31, 1953. But grants to Asia, aggregating over $1,307 million, were more than three times larger than grants to Latin America. The major beneficiaries of this government aid in Asia were: the Philippine Republic, $843.2 million; Israel, $293.2 million; India, nearly $290.2 million; Indonesia, $226 million; Iran, $107.6 million; and Pakistan, $99 million. Ceylon and Nepal got the smallest shares, the second receiving $493,000 and the first only $46,000.

Africa's portion of the assistance given by the United States Government to the underdeveloped countries during the period under review was comparatively small. It amounted to only slightly more than $169.2 million: less than $14 million in grants and almost $155.3 million in loans and other credits.

---

which went mainly to the economically retarded regions. In fact, the inspection will not include even some of the direct aid, such as $90.4 million for Palestine relief, at least $13.6 million for the Inter-American Highway, and a million or more for Nicaragua's Rama Road.

The Union of South Africa got some $62.4 million, all in the form of loans and credits. Liberia received more than $25.5 million and Egypt nearly $21.7 million, while the various European dependencies in Africa obtained almost $49.8 million. The smallest share, among the independent countries, went to Libya, a grant of a little better than $3.2 million.

TABLE 1

DIRECT AID TO LATIN AMERICA BY THE GOVERNMENT OF THE UNITED STATES, 1945-1953

Country	*Loans and Other Credits (thousands)*	*Grants (thousands)*	*Total*
Argentina	$100,063	$ 198	$100,261
Bolivia	35,205	6,478	41,683
Brazil	454,385	15,257	469,642
Chile	118,546	7,280	125,826
Colombia	55,872	3,648	59,520
Costa Rica	85	4,625	4,710
Cuba	22,490	780	23,270
Dominican Republic	———	1,189	1,189
Ecuador	17,333	5,458	22,791
El Salvador	576	2,513	3,089
Guatemala	———	4,638	4,638
Haiti	3,055	4,889	7,944
Honduras	223	2,287	2,510
Mexico	187,391	99,720	287,111
Nicaragua	600	1,812	2,412
Panama	4,000	3,006	7,006
Paraguay	795	5,284	6,079
Peru	21,515	9,186	30,701
Uruguay	11,554	1,506	13,060
Venezuela	13,303	1,811	15,114
Unspecified	5,267	219,485	224,752
Total, Latin America	$1,052,257	$401,050	$1,453,107

This modest sum may be compared with the following totals for all types of government aid to the smaller Latin American countries: Costa Rica, $4.7 million; El Salvador, a little over $3 million; Guatemala, a gift of $4.6 million; Haiti, $7.9 million; Honduras, $2.5 million; Panama, $7 million; and Paraguay, $6 million. Peru's assistance, $30.7 million, exceeded Liberia's by $5.2 million, and Ecuador's $22.8 million

TABLE 2
DIRECT AID BY THE UNITED STATES GOVERNMENT TO VARIOUS COUNTRIES IN ASIA AND AFRICA, 1945-1953

Country	*Loans and Other Credits (thousands)*	*Grants (thousands)*	*Total (thousands)*
Egypt	$ 17,934	$ 3,750	$ 21,284
Ethiopia-Eritrea	3,399	3,186	6,585
Liberia	22,322	3,249	25,571
Libya	.....	3,259	3,259
Union of South Africa	62,378	.....	62,378
Other Africa (1)	49,240	531	49,771
Total, Africa	155,273	13,975	169,248
Iran	34,384	73,216	107,600
Iraq	889	2,257	3,146
Israel	132,047	161,183	293,230
Jordan	.....	5,984	5,984
Lebanon	1,550	4,728	6,278
Saudi Arabia	19,112	3,139	22,251
Syria	.....	498	498
Total, Near East	187,982	251,005	438,987
Afghanistan	20,327	492	20,819
Burma	5,043	15,823	20,866
Ceylon	.....	46	46
India	234,212	55,986	290,198
Indonesia	124,815	101,256	226,071
Nepal	.....	493	493
Pakistan	15,136	83,860	98,996
Philippine Republic	124,442	718,794	843,236
Thailand	7,255	16,591	23,846
Other Countries (2)	1,501	62,782	64,283
Total, Other Asia	$532,731	$1,056,123	$1,588,854
Total, Asia	$720,713	$1,307,128	$2,027,841
Total, Asia and Africa	$875,986	$1,321,103	$2,197,089

(1) Other Africa includes: Belgian Congo, British East Africa, Gold Coast, Nigeria, Sierra Leone, Northern and Southern Rhodesia, Algeria, French Morocco, Tunisia, and French Equatorial Africa.

(2) Other countries in Asia include Indochina, Federation of Malaya, and New Caledonia. The last received a credit of either $1,501,000 or $1,502,000; both figures appear in the tabulations of the Office of Business Economics, U. S. Department of Commerce.

exceeded Egypt's by more than a million. Fuller details are presented in Tables 1 and 2.[4]

II

Grants, loans, and other credits distributed by the government of the United States among the economically retarded peoples were larger during the last four years of the period under examination than during the first four and a half years, larger in the major areas as a whole and larger in respect to most of the individual countries. Among the conspicuous exceptions were Mexico, Guatemala, Uruguay, Egypt, Saudi Arabia, Indonesia, and the Philippine Republic.

Total assistance to Latin America during the entire period was $1,453.1 million; assistance during the last four years of it amounted to nearly $987.2 million. Loans and other credits extended to Latin America during the whole period aggregated $1,052 million; for the last four years of it the aggregate was almost $704.3 million. Grants to Latin America

---

[4] The statistics presented in this essay have been compiled from the following publications of the United States Department of Commerce, Office of Business Economics: *Foreign Transactions of the U. S. Government (Basic Data through December 31,1949)* (Washington, D. C., March, 1950); *Foreign Transactions of the U. S. Government: Foreign Aid (Basic Data through December 31, 1950)* (Washington, D. C., March, 1951); *Foreign Transactions of the U. S. Government: Foreign Aid (Basic Data through December 31, 1951)* (Washington, D. C., April, 1952); *Foreign Aid by the United States Government (Basic Data through December 31, 1952)* (Washington, D. C., March, 1953); *Foreign Grants and Credits by the United States Government: December 1953 Quarter* (Washington, D. C., April, 1954); *Direct Private Foreign Investments of the United States: Census of 1950* (Washington, D. C., 1953); and *Survey of Current Business*, Nov., 1949, pp. 18-22; Dec., 1953, pp. 8-14; and Jan., 1954, pp. 5-10. Specific references to the first five of these seem unnecessary; the appropriate tabulations can easily be found in each of them. I have had to make numerous calculations and perhaps I have made some errors. The problem was complicated by the constant revisions of the Office of Business Economics and my effort to use its latest figures under the assumption that they would be the most accurate. Information on the precise utilization of the funds—sanitation, transportation, public utilities, education, and general economic development—may be gleaned, of course, from the numerous Congressional *Hearings* on the Export-Import Bank and the various phases of the foreign assistance programs, especially those of the Senate Committees on Foreign Relations and Appropriations and the corresponding House committees. I shall not deal with this aspect of the subject in my survey.

from July 1, 1945, through 1953 totaled approximately $401 million; during 1950-1953 the aggregate was nearly $283 million, a good portion of it in the form of military aid. Argentina and Brazil, among the Latin-American countries, fared best during the latter part of the time-span under consideration, receiving nearly all of their assistance during the last four years of it.

Total assistance to Africa throughout the period aggregated slightly more than $169.2 million; during the last four years of it the total was nearly $132.6 million. Loans and other credits extended to Africa during the entire eight and a half years amounted to approximately $155.3 million; during the last four years of the period they aggregated approximately $120.4 million. Grants to Africa during the full time-span amounted to less than $14 million, while the total for the last four years was over $12.1 million. The Union of South

TABLE 3

DIRECT AID TO LATIN AMERICA BY THE GOVERNMENT OF THE UNITED STATES, 1950-1953

Country	*Loans and Other Credits (thousands)*	*Grants (thousands)*	*Total*
Argentina	$ 99,858	$ 9	$ 99,867
Bolivia	16,433	4,297	20,730
Brazil	401,494	6,412	407,906
Chile	51,603	3,038	54,641
Colombia	32,159	2,050	34,209
Costa Rica	.....	2,823	2,823
Cuba	12,000	356	12,356
Dominican Republic	.....	697	697
Ecuador	8,930	3,274	12,204
El Salvador	.....	1,429	1,429
Guatemala	.....	862	862
Haiti	2,545	2,365	4,910
Honduras	.....	1,727	1,727
Mexico	83,143	25,833	108,976
Nicaragua	600	1,452	2,052
Panama	2,876	2,658	5,534
Paraguay	.....	3,328	3,328
Peru	15,568	4,921	20,489
Uruguay	2,115	726	2,841
Venezuela	10,400	526	10,926
Unspecified	3,549	213,430	216,979
Total	$704,277	$282,919	$987,196

Africa and European dependencies in Africa received nearly all of their assistance during 1950-53; the Union, almost $61 million of its total of nearly $62.4 million; European depend-

TABLE 4

DIRECT AID BY THE UNITED STATES GOVERNMENT TO VARIOUS COUNTRIES IN ASIA AND AFRICA, 1950-1953

Country	*Loans and Other Credits (thousands)*	*Grants (thousands)*	*Total (thousands)*
Egypt	$ 331	$ 2,482	$ 2,813
Ethiopia-Eritrea	2,022	2,744	4,766
Liberia	8,676	3,158	11,834
Libya	.....	3,244	3,244
Union of South Africa	60,985	.....	60,985
Other Africa (1)	48,434	158	48,592
Total, Africa	120,428	12,146	132,574
Iran	4,574	72,349	76,923
Iraq	.....	2,255	2,255
Israel	124,737	143,044	267,781
Jordan	.....	6,120	6,120
Lebanon	.....	4,635	4,635
Saudi Arabia	4,768	1,537	6,305
Syria	.....	129	129
Total, Near East	134,079	230,069	364,148
Afghanistan	20,327	483	20,810
Burma	.....	15,822	15,822
Ceylon	.....	43	43
India	189,657	52,753	242,410
Indonesia	43,900	50,656	94,556
Nepal	.....	493	493
Pakistan	15,000	83,661	98,661
Philippine Republic	42,205	230,310	272,515
Thailand	1,040	16,558	17,598
Other Countries (2)	1,501	63,055	64,556
Total, Other Asia	$313,630	$513,834	$ 827,464
Total, Asia	$447,709	$743,903	$1,191,612
Total, Asia and Africa	$568,137	$756,049	$1,324,186

(1) See Table 2, Note 1.
(2) See Table 2, Note 2.

encies, approximately $48.6 million of their aggregate of approximately $49.8 million.

Aid extended to Asia by the United States Government from July 1, 1945, through the year 1953 amounted to approximately $2,027.8 million; the total for the last four years of the period was $1,191.6 million. Loans and other credits for the entire period aggregated $720.7 million and amounted to $447.7 during 1950-1953. Grants, always larger for Asia as a whole than loans and other credits, totaled over $1,307 million for the complete time-span and $743.9 during the last four years of it. Iran, Iraq, Lebanon, Afghanistan, Burma, India, and Thailand received most of their assistance during 1950-1953. Israel, Ceylon, Pakistan, and the European dependencies in Asia obtained nearly all of theirs, and both Jordan and Nepal got all of theirs, during these four years. Only Saudi Arabia, Syria, and the Philippine Republic received the major portions of their assistance between 1945 and the end of 1949.[5]

Complete statistics for the years 1950-1953 are set forth in Tables 3 and 4. A comparison of these with Tables 1 and 2 should make possible a well-rounded view of the increased assistance given during the later period.

III

If sufficient data were in hand for each of the countries, a significant comparison might be offered of direct public aid and private direct investment during 1945-1953. But such information seems to be lacking on the specific distribution of the expansion in private investment except for 1950-1952, and unavailable for some of the separate countries even for this short period. During these three years private direct investments of the United States in the underdeveloped areas increased to the extent of $1,717 million and assistance by the

[5] There are discrepancies in the statistics published by the Office of Business Economics for Jordan and European dependencies in Asia, so that Tables 2 and 4 indicate that they received more aid during 1950-1953 than during the entire period! Figures for the earlier and later time-spans should be the same for Jordan and practically the same for the dependencies (Federation of Malaya, Indochina, and New Caledonia). Not knowing which figures are correct or whether any of them are, I have included both in each case and have inserted the larger sums in Table 4 in order to attract attention.

government of the United States to these areas amounted to some $1,408.6 million, so that the total capital involved was no less than $3,125.6 million.

Private direct investments of the United States in Latin America rose during this period from $4,590 million to $5,758 million, an expansion of $1,168 million, while government aid reached $477.5 million. The main recipients of the additional direct private investment were: Brazil, $425 million; Venezuela, $148 million; Chile, $105 million; Peru, $82 million. The major recipients of direct government aid—the distribution of $126.3 million, mainly in the form of military assistance, is not specified—were: Mexico, $82.3 million; Argentina, $97 million; Chile, $48.3 million; Brazil, $28.4 million; Colombia, $28.2 million; Ecuador, nearly $10 million.

Private direct investments of the United States in Africa increased during this triennium from $269 million to $504 million, an expansion of $235 million, and government aid totaled $82.2 million. The major recipients of the additional private capital—among the independent countries; the dependencies are included in the total investment but the distribution among them is not available—were Liberia, $93 million, and the Union of South Africa, $89 million; and these two countries together got $36.2 million in government aid, nearly 44 per cent of the total for Africa.

Private direct investments of the United States in Asia—excluding Japan as well as Australia and New Zealand—rose during this three-year period from $928 million to $1,242 million, an increase of only $314 million; but direct government aid—excluding not only Japan, Australia, and New Zealand, but also China, Formosa, and Korea—aggregated nearly $849 million, around 80 per cent more than was allotted to Latin America. Most of the additional private capital went to the Persian Gulf region, although the exact amount received by each country in this region has not been publicly revealed. Private direct investments of the United States actually shrank to the extent of $34 million in Europe's Asiatic dependencies during 1950-1952. India received an increment of $36 million in the course of these three years; Indonesia, $12 million; Israel, $28 million; the Philippine Republic, $46 million. This left $226 million for the other independent nations of Asia, and those of the Near East no doubt accounted for most of it. The major part of the public aid was awarded to the Philippine

Republic, Israel, India, and Indonesia, although Pakistan's share for 1950-1952 was over $8 million and Thailand's more than $11.2 million. Aggregates for the main recipients of the some $849 million in government assistance were: Philippine Republic, $236.6 million; Israel, $211 million; India, $205 million; Indonesia, $76 million; European dependencies in Asia, mainly Indochina, $39 million.

In computing the aggregates for government assistance by the United States for these three years total grants have been added to total loans and other credits *utilized*. Some of the latter, however, were repaid during the period, so that the difference between loans and credits *outstanding* at the beginning of 1950 (or end of 1949) and those *outstanding* at the end of 1952 was smaller in most instances than the sums borrowed during the three years under inspection. For a few of the Latin-American countries—Brazil, Chile, Colombia, and Mexico, for illustration—the increase in outstanding loans and credits during the period was very much smaller than the total loans and credits they utilized.[6]

Table 5 clearly reveals two facts, however, no matter which of its last two columns is selected to represent public aid: (1) the Asiatic countries received far more direct government assistance than private direct investment in the course of 1950-1952, while the opposite was true of both Africa and Latin America; (2) Latin America obtained more capital from the United States during this triennium than did Asia and Africa combined, for Latin America's share ranged from $1,490.5 million to $1,645.5 million, while the consolidated total for Asia and Africa ran from $1,435.2 million to $1,480.1 million.

It is quite evident that Latin America's grants from the United States were much smaller than the grants made to Asia and Africa together or those made to Asia alone, smaller for both the entire eight and a half years and for the last quadrennium of the period (consult Tables 1, 2, 3, and 4 again). For 1945-1953 grants to Latin America aggregated a little over $401 million. For Asia and Africa combined they amounted to over $1,321 million, and for Asia alone (as

---

[6] In order to stress this point, two columns have been inserted to exhibit direct government aid in Table 5, which presents a comparison of private direct investment and direct government aid during 1950-52.

TABLE 5

INVESTMENTS OF THE UNITED STATES IN THE UNDERDEVELOPED AREAS: DIRECT PUBLIC AID AND PRIVATE DIRECT INVESTMENT, 1950-52

Country	*Private Direct Investment Expansion* End of 1949 (million)	End of 1952 (million)	1950-52 (million)	*Government Aid* 1950-52 (million)	
Latin America	$4,590	$5,758	$1,168	$477.5	$322.5 (1)
Argentina	329	393	64	97.0	96.8
Brazil	588	1,013	425	28.4	— 4.9
Chile	518	623	105	48.3	28.1
Colombia	194	234	40	28.2	16.2
Costa Rica	57	61	4	2.2	1.7
Cuba	619	686	67	6.5	— 4.0
Dominican Republic	102	123	21	0.3	------
Ecuador	16	14	— 2	10.0	7.7
Guatemala	104	108	4	0.7	0.7
Honduras	60	81	21	1.2	0.9
Mexico	374	490	116	82.3	39.5
Panama	337	383	46	4.6	4.6
Peru	148	230	82	9.6	8.5
Uruguay	51	71	20	2.4	1.6
Venezuela	1,036	1,184	148	7.5	5.3
Other Countries	57	64	7	22.0	14.6
Unspecified	------	------	------	126.3	107.1
Africa	269	504	235	82.2	72.8
Egypt	38	46	8	0.8	— 0.7
Liberia	47	140	93	10.0	9.1
Union of South Africa	105	194	89	26.2	25.1
Other Africa	79	124	45	45.2	44.7

Asia (2)	928	1,242	314	848.9	831.4
India	27	63	36	205.0	202.7
Indonesia	62	74	12	76.0	90.2
Israel	13	41	28	211.0	207.5
Philippine Republic	132	178	46	239.6	224.7
Other Independent Countries	467	693	226	78.3	67.6
European Dependencies	227	193	— 34	39.0	38.6
Grand Total	$5,787	$7,504	$1,717	$1,408.6	$1,226.7
Latin America	4,590	5,758	1,168	477.5	322.5
Asia and Africa	1,197	1,746	549	931.1	904.2

(1) Government aid in this column represents the sum total of grants and the *increase* in *outstanding* loans and other credits between the close of 1949 and the end of 1952. Government aid in the adjacent column is the sum total of grants and of loans and other credits *utilized* during 1950-1952, inclusive.

(2) Exclusive of Japan, Australia, and New Zealand in respect to private direct investment; exclusive of these three and Formosa, Korea, and China in respect to government aid. But there was no direct investment in China during the period and probably little or none in Formosa and Korea; and although Formosa and Korea received bountiful government aid during 1950-52, China, of course, got little or nothing.

defined in this discussion) they exceeded $1,307. million. For 1950-1953 total grants amounted to approximately $283 million for Latin America, $756 million for Asia and Africa together, and nearly $744 million solely for Asia.

But it is said that Latin Americans are primarily not so much interested in grants as in loans and other credits; and, if this be true, they have no good reason to complain, for the statistics presented in this inventory show that they have fared better, much better, in respect to available loans and

TABLE 6

AID BY THE UNITED STATES GOVERNMENT TO VARIOUS COUNTRIES IN LATIN AMERICA, ASIA, AND AFRICA: LOANS AND OTHER CREDITS

1945-1953 and 1950-1953

Country	*Total Utilized* 1945-53 (millions)	1950-53
Brazil	$454.4	$401.5
India	234.2	189.7
Mexico	187.4	83.1
Philippine Republic (1)	124.4	42.2
Chile	118.5	51.6
Indonesia	124.8	43.9
Argentina (1)	100.3	99.9
Israel (1)	132.0	124.7
Colombia	55.9	32.2
Union of South Africa	62.4	61.0
Bolivia	35.2	16.4
Iran	34.4	4.6
Peru	21.5	15.6
Pakistan	15.1	15.0
Ecuador	17.3	8.9
Egypt	17.9	2.5
Cuba	22.5	12.0
Liberia	22.3	8.7
Venezuela	13.3	10.4
Saudi Arabia	19.1	4.8
Uruguay	11.6	2.1
Thailand	7.3	1.0
Panama	4.0	2.9
Ethiopia-Eritrea	3.4	2.0

(1) Official relations between the United States and Argentina were not entirely cordial during this period. Influences and attitudes in the United States and problems confronted in the Philippine Republic and Israel resulted in special consideration for these two young nations.

other credits, than either Asia or Africa. Table 6 should make this evident beyond dispute. It pairs 24 countries of the three major regions under consideration on the basis of the total loans and credits they actually utilized during the whole time-span and during the last four years of it. In most cases the treatment of the Latin-American countries was more generous than that accorded the countries of the other two regions dealt with. Particularly outstanding are the loans and other credits utilized by Brazil, Mexico, Chile, and Argentina.

The Economic Development of Nicaragua[1]

By ANDREW G. FRANK *

"Nicaragua *is* a political entity par excellence. In few countries do politics constitute such an important element of daily existence or affect more pervasively the economic and financial structure."[2] "Government policy toward business *should be* based on economic rather than political considerations."[3] (my italics). The second quotation, taken from the Report, neatly sums up the position, and therewith the contribution, of the mission in regard to the problems faced by Nicaragua. This position may be due simply to naivete. If so, enough said. But this is unlikely. The position stated may be due to political considerations involving the mission itself. If this is the case, it is beyond the scope of this paper. Instead, I wish to suggest another factor, a conception about the world, which may underlie the program presented in the Report. The conception, whatever its origin in the minds of the mission members, is one which has at different times been derived from Adam Smith's invisible hand or from Jeremy Bentham's utilitarianism, or from an observation of the working of, often a reification of "mature capitalism."

Nicaragua appears to have an almost unparalleled potential for economic development. It is well endowed with natural resources, excepting hydroelectric power. It has a low but fast growing (2.5% per annum) population; extensive unused land; a favorable combination of highly production volcanic land with six months rainfall in the West and more moderately

* Research Center in Economic Development and Cultural Change, University of Chicago.

[1] International Bank for Reconstruction and Development: *The Economic Development of Nicaragua;* Johns Hopkins Press, 1953. This paper is not intended as a book review. I examine only those propositions in the book which serve my purpose. I use the book for the development of some concepts, which concepts should have more general usefulness in the field of economic development.

[2] Cumberland, W. W.: Nicaragua, *An Economic and Financial Survey,* U. S. Government, Washington, 1928, p. 2.

[3] *Ibid.; op. cit.,* p. 100.

productive stretches of land with almost continuous rainfall (nine months) in the East; the possibility for increased crop variation; industrial opportunity in the existence of a variety of minerals; no technical obstacles to the solution of transportation problems—indeed two sea coasts and a conceivably magnificent inland waterway—a small internal market, but accessibility to the Central American market; and, at least for the present, a very good balance of payments position and availability of foreign loans. Yet Nicaragua remains extremely underdeveloped in relation both to its potential and to other countries with the same or less potential. Why is this so? There must be a reason.

The Report outlines the following "principal weak points in the past," which correspond, it says, to the "social, economic, and governmental weaknesses typical of the underdeveloped countries": low health and education; archaic fiscal system; poor transportation; ineffective credit system; no observance of long range planning; ineffective credit system; inadequate public administration.[4] In the "past two years the government has demonstrated imagination and the will to move forward."[5] The "structural weakness of the economy" are to be removed in accordance with the proposals set forth in the report (95 out of 413 pages are devoted to the fiscal and administration system alone). Knowledge is to be increased about the possible accomplishments of fertilizer, crop rotation, better seeds, etc.—this to be done by demonstration. Credit is to be made available so that the knowledge can be put to use. And economic development should proceed rapidly. "Success depends on the introduction of ideas new to Nicaragua," the Report maintains. But more important, the Report says in effect that the introduction of new ideas is tantamount to economic development; that the new (correct ideas) will be used.

Introduction of new *ideas; demonstrations;* fiscal *system; administration;* a program built on these appears to be based on the following position: Achievement of welfare is prevented by the administration institutions; alter these and people will be able to serve their own interests rationally; the proposed system will permit auto-oriented individuals to promote the general welfare; private benefit and social benefit are equated;

[4] *Ibid.*, pp. 3-4.
[5] p. 5.

people may be irrational now, but they will soon be rational if only the system will permit them.

It seems unlikely that Nicaragua has not availed itself of the opportunity for economic development merely because she does not have the right fiscal and administrative system. Instead, it may be suggested that the conduct of Nicaraguans in power is from their own standpoint more economically rational than is often assumed. *Time* magazine (Feb. 1, 1954; p. 28) tells us that President Somoza owns 10% of the arable land; that *his* diversified interests (holdings) have helped transform Nicaragua from a one-crop country; that roads are built to his holdings; that "everybody knows what is good for Tacho (Somoza) is good for the country"—and things are good for Tacho. But by implication what is not good for Tacho is not good for the country, and roads that are not to his interest (or his co-power holders) are not built. Cumberland in 1928 counselled that the same Rama (West-East) road be built which the IBRD Report still recommends. (The U. S. Government has now appropriated funds for it as has the Nicaraguan government.) The suggestion of the paper is that "politically" determined behavior on the part of the Nicaraguans (or others) may be economically very rational from their point of view; and that our failure to recognize this stems from our habit of looking at the world in terms of the classical economic system—particularly the identity of private and social interest which it entails; and that this conception is certainly less applicable to underdeveloped systems than to the more developed ones. The dilemma presented by the opening quotations would then be resolved as follows: The Nicaraguans *do* respond to political incentives; the Nicaraguans not so much *should* be, but *are* guided by economic considerations; indeed, their political organization and its operation gives expression to the economic considerations; it is economically ratonal for the people in power (though possibly not for the community as a whole) to serve their ends by "political" means. The issue would seem to resolve itself into an ethical one; "precisely whose interests are to prevail?"

Similar questions arise in connection with propositions such as the following one in the IBRD report (p. 19):

> "part of the investment in the public sector is predicated on the unwillingness or inability of local private capital to undertake risks in industry and agriculture because of psycho-

logical factors, a preference for commerce, land speculation, usury or other factors."

This passage raises several questions on each of at least two levels: one, the conduct attributed to the Nicaraguans by the missions; and two, the implications, in the eyes of the mission, of Nicaraguan actions for economic development.

Questions on the first level have already been under discussion. In the above passage as well as elsewhere, the Report attributes motives to the Nicaraguans which would account for land speculation, commerce, etc., on grounds other than economic ones. They speak of psychological factors; of what may be interpreted as an "esthetic" preference for commerce, etc.; and they might well have added here the political factors they speak of elsewhere. It may be quite valid to attribute such motives to the Nicaraguans. What is at issue here is whether the report, or we, should let it go at that. This paper suggests that it may be fruitful additionally to ask whether rational economic conduct would not also lead the Nicaraguans in question to invest in commerce, land speculation, and usury. The answer would probably be yes, it is rational, possibly the only intelligent thing for the Nicaraguan of means to do. The supply price of effort is high. Under conditions of monetary and other instability, liquidity is at a premium: commerce and land speculation provide liquidity. Moreover, under inflationary conditions money is a poor store of value, and land takes on the functions of a constant-purchasing power bond: it becomes one of the best stores of value available. Why then condemn such use of resources? Because it is not rational with respect to the communities' set of values, or at least it serves them less well than some other use might. The conditions of private and social benefit maximization are not the same.

So what? Well, if the conditions giving rise to maximum or greater social welfare are known (a big if), all that need be done is so to guide the decisions and conduct of decision making units that this maximum is achieved or approached. This can be done in a number of ways: it can be done by fiat (conceivably), by force, or by various (other) forms of persuasion. Only for a "free" society does the equation of private and social benefit present a particularly interesting or difficult problem. The problem has been well discussed by Alfred Marshall and A. C. Pigou, and in the public finance literature. The solution is so to set up or change around the system of incen-

tives, which incentives motivate behavior, that the private decisions made will serve the public end. That is not an easy solution; fortunately it is not the task of this paper to find it.

Instead it must be pointed out that for this equation to take place, if it does not come about "naturally," there must be some agent to do so; to want to do so, and to be able to do so. If such a dictator exists, fine—if freedom is not highly valued. If there is none, then not even force, much less suasion, can bridge the gap. It appears that in Nicaragua no such agent exists. A vicious circle: private effort does not automatically serve social end (even if this end exists, which is doubtful); therefore private gain is not served by social action; therefore, private power has no incentive to change the system. A solution would seem to have to come from outside the circle in the form of some other force: it is no happenstance, most likely, that the three major examples of "late" economic development, Germany, Japan and Russia changed under pressure of military circumstance.

The quoted passage also implies, and almost every other work in the field states, that land speculation and usury constitute an active interference with economic development. This is not the case. The questions on this, the second level, are strictly economic questions about the consequence for economic development of the use of resources by their owners. The assertion that investment in land and usury is an investment which does disservice to economic development is due to a semantic confusion. Although a rational investment, as we have argued, for the individual, this sort of disposition of resources is no *investment* at all for the community. It is merely a redistribution of resources among owners, and as such in no way *uses* resources at all

The society's command over resources is not dissipated by the transfer of land from one man to another. It is merely a mutual exchange of forms of command over resources among individuals. The question of what happens to the resource either from the point of view of the individual or from that of the society is an entirely different one. If the seller of the land uses the funds received to buy other land and the buyer turns around and sell the land again, they may not be engaging in productive social investment, but they are not, as is claimed, engaging in bad social investment (except possibly of enterprising capacity and time) either: they are not investing at

all. Only if the funds are used for beautifying hedges on the land, or importing air-conditioned Cadillacs to patrol it, are they mis-investing the resources from society's point of view. And only if they irrigate it (for instance) are they investing productively. But this is an entirely different question, which should be examined on its own merits. Importing luxury consumer goods *may* be a poorer use of Nicaraguan resources and irrigating a better use than alternative ones, but neither decision should be confused with land speculation.

Similarly, usury constitutes a transfer of resources from the peasant to the money lender. Consequently it is desirable from his point of view. If it is socially undesirable that is not so because the transfer itself constitutes a misuse of resources. The question turns on which of the two possible owners involved would use them more productively. One frequently hears it maintained that the peasant does not invest his resources productively; that inequality of incomes renders development more possible; that the money lender is more prone to investment than the peasant and his income better subject to taxation than that of the latter. Then why is at the same time such a cry raised on *economic* grounds that the peasant rather than the money lender should have command over those resources? Does not the peasant by his sacrifice of resources finance development through the money lender who acts, or could act, as fiscal agent of the government—if in turn the government could assure productive use of the resources—by giving them, for instance, to that group of peasants who would use the land productively? The elimination of the money lender then may be desirable on various grounds, but it alone does not serve to hasten economic development. Commerce may or may not be in a different class from the above two matters. Insofar as it, too, merely redistributes existing resources internally it cannot be said to be misinvestment, excepting again of enterprise. Insofar as it does something else, the preceding does not apply. It may be useful to investigate further the influence of "commerce" on economic development.

This question is similar to the problem of determining the potential contribution to economic development arising out of a particular use of any resource. The following criterion suggests itself as an aid: How subject to increasing returns is that expenditure of resources? Adequate tools, conceptual or statistical, do not yet exist to determine this. They should be

developed. But this consideration is not sufficient explanation for the complete absence of any evidence in the Report that the problem of economic development is one of increasing returns, that the act of developing an economy economically consists of deciding on new and more advantageous combinations of resources, possibly of new resources or better qualities of old ones, and of carrying these decisions into action.

The program for the economic development of Nicaragua recommended in the Report consists principally of a "modernization" of the fiscal and administrative agencies of the government. Other than that, it puts emphasis on the improvement of transportation facilities. It recommends greater and better development of the cattle industry for the eastern slopes. As to industry, the recommendations appear to be based on the following principle: if a product is now imported but can be produced by local resources, establish or enlarge that industry. But no suggestions, or to my mind no correct suggestions, are offered the reader, Nicaraguan or otherwise, on how to get a view of the developmental, or *a* developmental process. The "produce for yourself what you can" criterion is no substitute for the increasing returns concept and the criteria it may provide. The mission proposes a program "designed to enable the country to go forward *simultaneously* in health, education, transportation, agriculture, industry and power" (my italics), but it nowhere demonstrates that it is wise for Nicaragua, given the limited resources at hand, to move ahead a little at the same time on all these fronts. Might not a program of the following sort be advisable for a country in which there is little or no popular pressure for immediate physical gains: undertake an educational-psychological-cultural "development," such as occurred in Canada (or English-speaking Canada, which provides an interesting contrast with Quebec) ; this then permits a very rapid physical development on the base of an *already* developed population. That is, develop human resources first. If the physical resources are available and the right spark is now introduced into Uruguay, that country probably would immediately outpace all other Latin American countries.

Examination of the report suggests a couple of other questions which may usefully be considered. I have answers to neither of them. The mission suggests a "minimum" program which must be carried out to attain a "minimum rate of devel-

opment" and an "optimum" program which is less urgent. The minimum program involves an investment of about 11%, the optimum of 14%, of the national income. There is no indication of why 11% investment produces a rate of growth which is minimum. Nor do the conditions prevailing in Nicaragua appear to imply a minimum or any other rate. The Nicaraguans have gotten along as they are now for years, and no new pressures are in evidence; at any rate the Report does not speak of any other than 2.5% per annum population growth in a country with arable land many times that which is now cultivated. Where are we to find a minimum and how can it be calculated? The mission apparently merely adopted the "normal" recommended rate of about 12% which advanced countries can achieve. But this is neither a minimum for any place nor a maximum for every place. If in some instances it is a maximum, it is generally not demonstrated for those *particular* places and certainly was not even discussed for Nicaragua. If the criterion is population growth and a consequent need for more food, then we seem to be speaking about increasing the flow of food produced or acquired through exchange. But this is not a per capita growth (with which development is often associated), and it really says nothing about development at all. Is growing more food the same as economic development?

On page 103 under a section entitled "the manpower problem" we find the following words: "The small manpower supply, while a problem, is a long run asset since it will be generations before Nicaragua feels the population pressure typical of so many underdeveloped countries. The population, however, is expanding at the rate of nearly 2.5% a year and this high rate of growth makes the need for developing the country's resources even more great." This statement deserves analysis. It seems a misuse of the term "asset" to claim that a small supply of manpower is an asset *"because"* it will be generations before Nicaragua feels the population pressure . . ." Lack of population pressure is an 'asset" only by indirection; a "small" supply of manpower is no asset at all, except possibly to labor, because of its conequently greater marginal productivity. But Nicaragua does have an asset: a population growth of 2.5% per annum, and that because, given the large supply of other factors, there are increasing returns to population growth in Nicaragua. Otherwise put, the asset is the plentiful supply of complementary factors noted in the opening paragraphs.

That is, because capital formation through population growth appears initially to be easier than through physical capital accumulation, the low population-high land combination appears to be more favorable initially for economic development than its reverse.

The mission claims the wrong thing (small supply) to be an asset and does not claim the right thing (population growth) to be an asset. Why? I suggest that they, and maybe we too, are so influenced by the prevalence of population pressure in *some* places that they cannot divest themselves of the fear therefrom when it is not warranted by the facts of the country under study. I suggest further, that the Malthusian problem is generally overemphasized. Population growth is much more *desirable*, I suggest, than students of economic development now think. From the production side it is much more subject to increasing returns, even assuming the other factors, lands, capital and technique, fixed, than we sometimes think. If the latter three factors are open to change population increase will be all the more desirable. We have over-emphasized the consumption (I hesitate to say "demand") side of the question of population increase. Equally important, we have not adequately studied the relation between supply of labor and the demand by population. Such study would throw more light on the question of desirability of population growth generally or in a particular case.

What conclusion can we draw from the preceding discussion? It is, I think, that the authors are not, as we must be, careful in the use of words. (This paper also probably suffers from nonobservance thereof.) "Economic development," "economic," "rational," "political," "investment," "population growth," "minimum program" are all used without due regard to their meaning to and applicability in the context in which employed. Sloppy writing is the result of sloppy thinking, often the result of not thinking. Of course, it is thought which is more important in a reasoned, though not necessarily so in a propagandistic, document. The authors of this Report appear in several instances to take a word variously used in different contexts and finding the term apparently applicable in the context at hand—Nicaragua; to react in a manner appropriate in one context, but inapplicable and inappropriate in the context in question. Their reaction is to the word itself, not to the situation which is its referent. This leads to thinking less

in terms of the proper consequences of, and reaction to, the real situation—be it investment in land or growth of population, or equation of private and social benefit—than in terms of the traditional relations among the words used.

Broadening the Industrial Front in Venezuela

By VIRGIL SALERA*

To most people in the insufficiently developed areas themselves, and to some individuals in the so-called advanced countries, "economic development" is regarded as synonymous with "industrialization." To progress economically, a country "must" have more industries—factories replete with fancy equipment, belt conveyors, at least one four-by-four hydraulic lift truck in the warehouse, and a tall chimney that dominates the immediate landscape. The "advanced" countries have such installations by the thousands, *ergo* the insufficiently developed countries must acquire them rapidly lest they remain forever in economic limbo. I shall never forget an international club meeting which I attended several years ago, as a faculty moderator at a medium-size college in Ohio, at which a loquacious young Panamanian argued passionately that his country would be much better off if only it had a small match factory of the kind that existed in neighboring Costa Rica. It happens that the simple industrialization theme fits the requirements of many underdeveloped areas, especially those that are markedly overpopulated with visible excesses of human resources in agriculture. India is a case in point. But Venezuela is not such a country.

Status of Venezuelan Industry. In the jargon of economics, an industry is a firm or group of firms that produces a single "product," and a product is a thing (or service) that is imperfectly substitutable for another thing. If three distinctly different physical things are perfectly substitutable, they constitute a single product in the language of the economist. As a definition, this is all right. On the empirical front, however, where to draw the line between industries and products often baffles the most sophisticated theoretician. In fact, such

* Dr. Salera has been economic adviser to the Corporación Venezolana de Fomento, and more recently director of the Mantaro Valley Survey, Huancayo, Peru. This paper is a chapter from a book manuscript titled "Venezuela's Dynamic Economy."

esteemed gentlemen have a penchant for extremely arbitrary action when they leave the classroom blackboard or neat logical analyses of the professional journal. The classroom abstractions have their place, of course. But they are not very helpful in dealing with the imperfectly known Venezuelan economy.

Hence, I shall use the term "industry" in its commonsense meaning, as applying to firms that turn out fairly clear-cut products or closely related items. The "textile" industry illustrates one case; shoes would illustrate another; steel, a third. On this basis, Venezuela's present-day industries can be ranked on several bases, depending on the classification system. One classification might be based on the number of employees in the industry; another might be the value of its annual output; a third might be the quantity of capital invested in it. For Venezuela, a combination of the three seems to be necessary, since data of the same kind are not available for all industries across the board.

Industries Ranked by Employment. If the volume of employment is used as the basis of classification, the country's main industry is the textile industry. Not far from half of all factory employment is in this industry.[1] The full range of textile products is produced in the country, though cotton textiles predominate. Rayon is next in rank. Most of the output is produced in small factories employing a few dozen workers, but there are also some large firms. Thus, a large American firm dominates the rayon yarn industry, producing acetate yarn. Another large American concern is in the industry, making viscose rayon textiles from imported yarn. By and large, this is an inefficient industry, which enjoys very heavy tariff protection. The shirt example, a not extreme one, illustrates what I have in mind: The duty on a typical medium-priced cotton broadcloth shirt amounts to about the United States retail price. If the shirt is of the heavier basket-weave type, the duty is considerably higher.

Not far behind textiles as a source of employment is the food processing group of industries. Meat processing, cereal production and bakery output, sugar refining, vegetable oil production, and the like loom large in this category. Third rank seems to be held by the construction industry. Most of the remaining industrial categories are relatively small, in

[1] Many finished textiles are also produced on a household basis.

terms of employment offered. Even oil production falls under the heading of a relatively small industry, employment-wise.

Ranking Based on Value of Output. Ideally, an enumeration of industries on a value-of-output basis should be grounded in data showing value added in production. The Venezuelan statistical information, however, is not sufficiently detailed or complete to permit such a treatment of the matter. The best available data, shown in the following table, are in terms of gross value of production, so that double counting in some degree is involved in the figures. Nevertheless, the data are of some significance.

TABLE 1

GROSS VALUE OF OUTPUT BY MAIN INDUSTRIES, 1952

(In millions of dollars)

Extractive (oil mainly; also iron ore, gold and diamonds)	1,341
Construction	383
Food processing (meat and fish, cereals, sugar, alcoholic beverages, dairy products, vegetable oil, non-alcoholic beverages, and canned foods)	288
Electricity	56
Textile	45
Hide and skin	40
Construction material (cement, bricks, and tile)	38
Tobacco	28
Metal-working	26
Chemical	10
Tire and Tube	8

Source: Data supplied to the author by the Banco Central de Venezuela. The *net* value of production in petroleum refining during the year was $63 million.

On the basis of general information, I would say that the industries would be ranked in approximately the same order if the basis were value added in production. Perhaps the metal-working category would outrank tobacco, however. Clearly, the dominance of oil shows up in the data on value of production as well as in many other ways.

Industrial Self-Sufficiency. Venezuela is self-sufficient in a number of industries, apart from the extractive export industries. By self-sufficient I mean a condition in which minimum national requirements or domestic demand is met from domestic output, so that some imports, especially of high-price or luxury types, are consistent with this idea of self-sufficiency. Thus, the country is self-sufficient in most textiles, in portland

cement, non-alcoholic beverages, beer, soap, furniture, many processed foods, shoes, and one or two others.

In the near future, it is likely to become self-sufficient in the simpler glass products, tires and tubes, many paper products (made from bagasse), some chemicals such as sulfuric acid, caustic soda, chlorine, paint and varnish. Most of these industries appear to be competitive with imports either on a low-duty or duty-free basis.

It is not meant to imply that self-sufficiency is necessarily a desirable goal for Venezuela, except in a few instances when non-economic considerations may govern. In fact, it is doubtful whether it is in the country's true economic interest to seek self-sufficiency if it cannot be attained without government assistance. As I have argued before, self-sufficiency that requires public assistance is likely to involve the construction of a minimum size plant that is too large for the market, or if it is of suitable size it is likely to involve a monopoly problem. At a later date, when the market will have expanded population-wise and per capita real income will be higher, plants of minimum size may not involve excess capacity and thus excessive unit costs. In all such cases, it will be best to postpone the introduction of new industries and desirable, on economic grounds, to delay the attainment of anything like self-sufficiency. If the idea of self-sufficiency cannot be removed from the minds of the people, then it is in the field of basic agricultural products that the concept should be confined. Even here, self-sufficiency as such probably will make economic sense only in exceptional cases; far more satisfactory would be policy which called for expansion of output and the stockpiling of a few key commodities to deal with emergency situations.

The case of steel is a special one. As has previously been indicated, it appears that Venezuela will be able to build an economic steel industry if some technical plant problems are solved and if, in addition, (1) cheap fuel is obtained in the form of petroleum coke or in the form of imports carried in iron ore boats that would otherwise make the return voyage empty, and (2) the industry's output is carefully restricted to the simpler steel products in wide demand within the country. There is a tendency in many circles to poohpooh the idea of a steel industry in a country of Venezuela's size; to be sure, such an industry generally is uneconomic in countries having

a small market. In Venezuela's case, however, the difference between the cost of iron ore delivered at its mill site (assuming that this will be on or near the Orinoco, or at least not west of Puerto La Cruz) and the cost delivered at the world's main import center (the Chesapeake Bay-Delaware River area) will probably be more than enough to cover the cost of shipping coke and coal to Venezuela. (This assumes that a Venezuelan mill, with government support, would be able to negotiate freight rates at slightly above the variable costs of handling coke and coal shipments on vessels that would otherwise move empty to Venezuela, whereas the northbound ore rate would cover full costs.) In short, the Venezuelan mill would probably be able to have a combined ore and fuel bill not much different from the combined bill for such items at Atlantic coast mills in the United States. Such a cost position with respect to two of the main elements in steel costs is a source of strength. It could more or less offset disadvantages in limestone and high capital costs, and thus enable a Venezuelan mill to be competitive with imported finished steel products in the simple items which could readily be absorbed on a volume basis in the local market. An optimist might even argue that Venezuela could export some of the simpler mill products to neighboring markets in which it would have a transport cost advantage.

If the above reasoning with respect to steel is correct, there would be another advantage of considerable importance. Such an industry would give a fillip to the production of numerous chemical by-products of steel, thus expanding the opportunities for employment of technicians in Venezuela. The secondary effects of steel might therefore be to hasten the development of a well-rounded corps of native technicians working in a basic industry and its satellites. Knowledge of above-average opportunities for technicians in steel and by-product industries would probably do more to diversify the country's engineering skills than any other measure that comes to mind. At the moment, scarcity of competent technical talent almost ranks on a par with the main obstacles to industrial development.

Principal Problems of Industrial Development. Perhaps the main problems of industrial development, in the order of their importance, are high labor costs, high capital costs, limitations of the market, insufficiency of qualified local technical per-

sonnel, high internal transport costs, and the lack of cheap electric power.

Labor Costs in the Petroleum Industry. The combination of relatively high wage rates and relatively low labor productivity spells high labor costs. With the exception of one or two industries, the oil industry pays the highest wages in the country. The following table gives the particulars for the nation's largest private employer, the company that accounts for about 45 per cent of total oil output. In 1952 the Creole

TABLE 2

DAILY WAGE BILL OF THE CREOLE PETROLEUM CORPORATION, 1952

	Bolívares	*Dollars*
Basic wage	20.14	6.01
Additional cash payments:		
Night shift, overtime, etc.	4.75	1.42
Profit sharing	5.17	1.54
Rest day	3.42	1.02
Housing allowance	2.35	.70
Pro rata share of annual vacation	1.90	.57
Contribution to Savings Plan	1.35	.40
Legal holidays	.48	.14
Loss of time on account of industrial accidents	.09	.03
Non-industrial accidents and illness	.13	.04
Total additional cash payments	19.64	5.86
Total cash outlays	39.78	11.87
Supplementary contributions:		
School account	1.75	.52
Hospitals and dispensaries	6.51	1.94
Housing supplied	4.66	1.39
Commissary benefits	1.76	.53
Recreational facilities	1.11	.33
Miscellaneous	.11	.03
Retirement Plan	2.31	.69
Old-age benefits	1.64	.49
Indemnity for accidents	.07	.02
Death benefits	.07	.02
Total wages and "fringe" benefits	59.77	17.84

Source: *Informe Especial a los Trabajadores de la Creole Petroleum Corporation*, Caracas, 1953.

Note: Items do not necessarily add to indicated totals because of rounding.

Petroleum Corporation paid its non-salaried employees an average of $17.84 in direct and indirect wages per day, as follows:

It will be noted that Creole made cash payments in 1952 to its non-salaried employees at the rate of $11.87 per day, or $4,332 per year; the total wage bill amounted to $17.84 per day, or $6,512 per year. For purposes of comparison, Venezuelan direct money wages of $4,332 may be said to represent about 10 to 15 per cent more than the disposable income of United States wage earners whose direct dollar earnings, before income taxes, amount to the same sum. The difference is accounted for by the levels of direct taxation in the two countries. Specifically, the Venezuelan worker pays an income tax of only 1 per cent on money wages of the indicated amount, whereas the American worker in that income bracket probably pays income tax to the extent of 10 to 15 per cent of his income, depending mainly on the number of dependents.

Clearly, wages in the oil industry are high; higher even than the wages of comparable employees in the United States. More important, they are high in relation to wages in most other industries in Venezuela and especially in relation to labor productivity in most other sectors of the economy. A further word will be said about this aspect of the wage problem in a moment. To avoid confusion, it is necessary to add at this point that oil wages equal to or higher than the United States level are consistent with lower labor costs per barrel than in the United States. This is due to the fact that the average well in Venezuela produces more oil per day than is the case in the United States.

Many competent observers, particularly visiting American economists, are struck with the impact of oil wage levels on wage patterns in the rest of the Venezuelan economy. Their interpretation, in effect, is that high oil-industry wages are frozen by law into the rest of the economy. Some interpretations go so far as to say that the law sets as a *minimum* standard the wages and employment conditions which only the oil industry can economically support. What they mean is that the direct wage bill and a part of the fringe benefits are "frozen" into the law of the land, since only the "extractive" industries under Venezuelan law are obligated to incur outlays such as for schools, roads, hospitals, and the like, in behalf of their employees. Actually, the impact of oil is not

quite as great as indicated. First, the basic oil wage, as the largest component of labor costs in that industry, influences other wages only indirectly, since it is not set forth as a legal norm which other industries must pay. In fact, basic wages in many other industries are considerably below the oil-industry level. Second, oil-industry fringe benefits are far more extensive than those common in most other industries, apart from the benefits that are provided by the companies by virtue of their status as an extractive industry. (See Table 3 below.)

There is an even more important qualification which should be made concerning the views of some economists with respect to the impact of oil wages on non-oil wages. I would argue that even in the absence of provisions in the law with respect to (non-extractive-industry) fringe benefits, a high-foreign-exchange-earning-industry such as oil would almost inevitably have permitted the economy to enjoy high wage levels outside oil—wage levels that are high in relation to (1) those prevailing in other countries that are no more developed than Venezuela (apart from oil), and (2) labor productivity in the country's non-extractive industries. In a country as small as Venezuela, as distinct from a "center country" such as the United States, balance of payments considerations are the ultimate arbiter of cost levels, including wages. As long as oil would foot the bill, wages and costs generally would be free to rise to levels at which the money income generated and expended on imports would be consistent with the high foreign exchange earnings. Hence, Venezuelan wages are high not so much because of the impact of oil-industry wages or Venezuelan law as because of the impact of oil prosperity, given the quantity and quality of labor and other resources in the country, and given the level of protection that is accorded most domestic industry.

In short, the oil industry's prosperity enables the country to enjoy relatively high money incomes and a currency with a high foreign value. The external manifestations of this unusual combination are high wage levels and relatively cheap imports. Postwar United States foreign aid to Europe may again be invoked to illustrate the indicated relationships. For several years, as is well known, aid enabled our European friends to pay for far more imports than would have been possible from the proceeds of their own exports. In a sense,

it may be said that the Europeans had high cost (and income) levels while enjoying cheap imports.

Non-Oil Wage Levels. Data for public consumption on wage and salary levels that prevail in industries other than oil are almost non-existent. Annually, however, the principal industries and businesses in the country, under the leadership of the main firms in the oil industry, make a detailed and fairly representative survey of wages that are paid on a monthly basis by some 130 participating firms. These industries also have employees who are classified as "daily workers," for whom fringe benefits are somewhat less favorable. Such workers earn almost the same hourly basic wages, but their cash income over and above the basic wage generally is less than that shown in the average case for workers on a monthly basis.

The relevant data, for the year 1952, show maximum, average, and minimum total monthly remuneration in all forms, broken down into the following categories: basic monthly wage, additional monthly payments on a cash basis, the value of benefits in kind, and dismissal wages. In terms of total effective remuneration, the highest average wages were earned by workers producing building materials. Next in rank were workers in the oil industry, some 15 per cent below the building materials group; and then workers in commerce, textiles, chemicals, construction, food processing, transport, public utilities, and banking. The particulars are shown in Table 3.

The figures in Table 3 are extremely interesting. Note, for example, that the average Venezuelan wage (total monthly remuneration, five and a half day basis) in each industry category is higher, sometimes substantially higher, than the comparable wage in the United States for the same year. To be sure, the United States figures exclude fringe benefits, such as noncontributory pensions and paid vacations. These do not inflate the American figures sufficiently, however, to change materially the picture that is shown in the table. Moreover, if allowance is made for taxes withheld at source, the differences between the Venezuelan and United States cases become even more marked than shown in the table.

Excluding the last two miscellaneous categories in the table, for which there are no comparable American data, the Venezuelan basic wage is higher than the average monthly earnings in comparable American industries in four out of ten

TABLE 3

WAGE LEVELS OF WORKERS PAID ON A MONTHLY BASIS, MAIN INDUSTRIES, 1952[a]

(In dollars)

Group		*Basic Wage*	*Additional Cash Payments*	*Benefits in Kind*	*Dismissal Wages Paid*	*Total Monthly Remuneration*	*Total Monthly Remuneration as a Percentage of Average Basic Wage*	*Comparable Average Monthly Wage for United States Industry*[b]
Food	Max.[c]	580	81	—	67	728		
	Avg.	296	87	2	15	401	135%	274
	Min.	193	25	2	7	227		
Banks	Max.	270	142	7	21	440		
	Avg.	211	67	1	11	291	138	218
	Min.	135	20	—	3	159		
Commerce	Max.	311	511	—	68	889		
	Avg.	257	177	3	14	451	175	253[d]
	Min.	188	69	—	13	270		
Construction	Max.	349	782	2	3	1,136		
	Avg.	318	69	15	4	405	127	367
	Min.	266	40	16	3	326		
Petroleum	Max.	320	141	130	21	613		
	Avg.	278	108	94	42	522	188	359
	Min.	339[e]	84	30	13	468		
Chemicals	Max.	379	321	1	1	702		
	Avg.	279	120	3	10	413	148	297
	Min.	187	81	3	10	281		
Building Materials	Max.	399	498	1	17	915		
	Avg.	374	229	6	17	626	167	274[f]
	Min.	338	66	13	13	430		

Public Utilities	Max.	326	118	40	16	500		
	Avg.	239	72	12	18	341	143	289
	Min.	96	13	—	—	108		
Textiles	Max.	309	175	5	44	534		
	Avg.	319	83	3	10	416	130	217
	Min.	211	55	11	8	285		
Transportation	Max.	383	179	13	97	672		
	Avg.	270	67	23	7	366	136	320
	Min.	195	21	3	6	224		
Other Industries	Max.	480	142	3	16	641		
	Avg.	370	76	39	14	499	135	n.a.
	Min.	330	20	—	—	350		
Professional Firms	Max.	399	359	—	4	761		
	Avg.	280	63	35	18	396	141	n.a.
	Min.	114	13	42	5	175		
Average for All Participants[g]		274	105	54	28	462	169	282[h]

[a] Excludes workers paid on a daily basis.
[b] Figures for June 1952.
[c] The maximum wage reported is heavily weighted by bonuses and the like.
[d] Unweighted average of wages in the wholesale and retail trades.
[e] The range for each industry group is based on total remuneration and not the basic wage.
[f] Unweighted average of wages of the lumber and stone, glass and clay products industries.
[g] Fringe benefits are often allocated somewhat arbitrarily as between workers on a monthly wage basis and those on a daily wage basis, owing to the character of the accounting data that is kept by some firms.
[h] Monthly average, all manufacturing industries.

Source: *Estudio Sobre Sueldos Básicos y Prestaciones Sociales de Empleados en Venezuela*, Cámaras de Industriales y de Comercio de Caracas, Caracas, December 1952, pp. 12-12A; *Survey of Current Business*, November 1952. Details do not add to indicated totals because of rounding.

cases. Again, if a comparison could be made of Venezuelan "take-home" wages and the equivalent in the United States, the Venezuelan disposable basic wage income would be higher than the American counterpart in over half of the industry categories. Clearly, industrial wage incomes and labor costs (apart from oil) are high in Venezuela, regardless of the refinements that might be made to obtain strict comparability between the Venezuelan and United States cases. Fundamentally, wages are high because of the efficiency of oil production. This industry's excellent foreign-exchange earnings permit many workers in the country to enjoy high money incomes without impairing the Venezuelan balance of payments position at the ruling exchange rate for the bolívar; hence bolívar incomes are converted into dollars at a rate that is very favorable to Venezuela if (arbitrarily) account is taken only of non-oil resources.

This raises another question: How do Venezuelan real wages compare with those in the United States? Unfortunately, there are several reasons why it is not possible to answer this question with reasonable accuracy. First, a national consumer price index does not exist. Second, the market basket that is sought by the typical Venezuelan worker is not at all like that which is sought by the typical American worker. For instance, the Venezuelan worker generally will want a full-time maid; for climatic reasons he and his family need much less clothing than his American counterpart (though such clothing is substantially higher in price than in the United States); he usually is satisfied with simpler housing, again partly for climatic reasons; and his food basket differs materially in composition from that of the American worker.

Nevertheless, my own impressions about Veuezuelan real wages may be expressed quantitatively. On the basis of my experience in several parts of Venezuela, discussions with people in various walks of life, and published family budget studies of limited scope,[2] I would say that Venezuelan money wages would have to be deflated about 25-35 per cent to put them on an approximate par, in real terms, with the wages of

[2] J. M. Bengoa, "Encuesta Alimentaria en Familias de las Clases Obrera y Media de Caracas," *Archivos Venezolanos de Nutrición*, Caracas, December 1950 and June 1951.

United States wage-earners.[3] Even with an adjustment of this sort, however, Venezuelan real wage income is fairly high. This can be chalked up as another fruit of a prosperous oil industry. Perhaps it is also a reminder that appropriate steps must be taken in time to effect an orderly transition to an economy in which there is less dependence on oil-financed imports.

A further point should be made in the light of the above wage data. There is a tendency for foreign observers to overemphasize the impact of oil wages not only on wage levels in other Venezuelan industries but also on employment and economic activity outside oil. One writer has even tried to account for the underdeveloped state of agriculture on the grounds that high oil wages have induced people to leave agriculture in excessive numbers. Specifically, this writer alleges that people "queue up for oil jobs, rather than work and save."[4] This, of course, is nonsense; first, because most Venezuelans know that there are relatively few jobs in oil (a mere 3 per cent of the labor force is employed in the industry, as previously indicated); and second, because the typical farm worker usually lacks the technical qualifications for work in the industry. There is a relationship between oil and the state of agriculture, but it is of the kind described above. Venezuelan agriculture is unquestionably in need of improvement and rebuilding; perhaps the last of its needs would be additional labor.

Finally, a word of caution is in order with respect to the generalizations that might be made from the above wage data. As has been indicated, the data apply only to wage-earners who are paid on a monthly basis. This covers the bulk of individuals employed in industry. A substantial number of people who are in the wage-earning category, however, work

[3] To Americans who have lived in Venezuela or to those who have read about Venezuelan prices in the popular American press, this estimate may appear to be too favorable to Venezuela. It is true that the money incomes of Americans in Venezuela have to be deflated by about 50 per cent to attain parity of real income with their professional counterpart in the United States. However, I am addressing myself not to the real income of Americans in Venezuela (whose level of living is considerably higher than that of wage-earners), but to the comparative real incomes of roughly comparable wage-earners in the two countries.

[4] C. P. Kindleberger, International Economics, p. 359.

on a day or on a piece-rate basis. By and large, the average monthly wages (and indirect wages) earned by such individuals are below those shown for more or less comparable categories of workers who are paid on a monthly basis. Moreover, the data that have been shown exclude some typical low-wage categories, such as gardeners, barbers, janitors in small buildings, messenger personnel (used rather widely in Venezuela), and domestic servants. In a relatively high-income city such as Caracas, for example, gardeners earn about $150 a month on a daily assignment basis, or about $90 to $100 in cash when the man lives with his employer (in both cases, fringe benefits usually are not earned). Domestic servants in Caracas usually earn from $45 to $75 monthly, in addition to board and lodging. The earnings of domestic servants are low in relation to United States levels, of course; however, before too many inferences are drawn from such data, it may be pointed out that few employers of domestic servants can get along with just a single person—two maids are usually necessary, partly because of cleaning and related requirements in a tropical area.[5]

Capital Costs. Fixed and working capital is more expensive in Venezuela than in some underdeveloped and many advanced countries because of fairly high interest rates and high wage costs in the construction industry. Thus most construction and installation costs are at least one and a half times as high as in the United States. Mortgage money ranges from 10 per cent to 12 per cent; common stock of good companies sells at prices to yield about 8 per cent to the buyer; and the debentures of the most solid public utility concerns, which enjoy an international market, involve an interest cost of about 6 per

[5] A word may be said at this point about the "utilidades problem" (profit-sharing or Christmas bonuses). Though an outgrowth of good fortune in oil, practically everybody now wants and gets some type of extra income at Christmas. The result is that, considering the prevailing relatively good money incomes apart from such bonuses, the economy is saddled with charges that are embedded in the cost structure to the detriment of potential export business outside a few extractive industries and equally of potential import-competing businesses. Even firms that are losing money are under great pressure to pay "utilidades," which in such cases rarely are less than two-weeks wages or salary. It appears that it will be necessary in due course to terminate such annual largesse and, in the few cases that parallel the oil business, to siphon such funds into the Treasury, for use in such ways as do not involve inflating the costs of private businesses.

cent to the borrower. Even government securities yield no less than 6 per cent.

In part, these rates reflect the absence of a broad securities market and the lack of a short-term money market. With few exceptions, corporate securities must be sold in a very thin market, so that even small sales usually appreciably depress market prices, while modest purchases will raise the price level in the market to a noticeable extent. In fact, there is a tendency to think of the capital market as limited by the resources of a few wealthy families. Moreover, the existence of real estate and relatively low-capital, fast-turnover opportunities in commerce makes industrial investment less attractive than it might be.

Limitations of the Market. A serious problem that faces Venezuelan industrial development is found in the smallness of the domestic market. If population is adjusted for the comparative level of Venezuelan per capita money income, Venezuela's market of over five million people becomes the equivalent of less than two million average United States customers. What this means with respect to industrialization on an efficiency basis is that in most cases the market is too small for plants of minimum efficiency size. All too often, therefore, there is a tendency to build a sub-optimum plant and to obtain high tariff protection in order to shelter such an inefficient producing unit. The consumer foots the bill, of course.

Moreover, as previously mentioned, if new industries are established in which the sole plant is of efficient size, the country immediately faces a monopoly problem, given the tariff protection that is usually accorded such industries. I have proposed a method of dealing with the protection and monopoly problems, but whether anything like such means will be used remains to be seen. I would not wager any substantial sum on the expectation that they will be used in the near future.

Insufficiency of Local Technical Personnel. To date, there are not enough native technicians that are necessary for an economy in the process of expanding and diversifying its industry. Engineers of most varieties are still foreigners to a considerable extent, who command premium incomes (and who earn them). However, a well-developed corps of local technical personnel will enable the country to lower its indus-

trial costs appreciably in the course of time, as they narrow the margin of superiority enjoyed by their foreign counterpart.

Even less sufficient is the quantity and variety of skilled industrial management. Management is a complex art, which draws heavily on a tradition that can be built up only slowly—a tradition that includes technical institutions and staffs with a keen interest in implanting technical knowledge, research laboratories of all kinds, a professional esprit de corps, technical journals by the dozens, organized professional societies each with its own traditions, including annual meetings, and so forth. Needless to say, relative deficiencies on the native technical level are common among countries in the early stages of industrial development. There is every reason to believe, however, that the deficiencies on this score will be remedied in due course, for Venezuela possesses an important advantage: there is a will to make rapid economic advance. Moreover, there is a propensity to accept innovations, to desire material change. There is even a recognition in wide circles that it is easier to adopt superior consumption habits than improved production methods, and that in consequence constant emphasis on the primacy of the latter is a necessary precondition of economic progress.

Internal Transport Costs. The "Venezuelan market" is partly a figment of the economist's imagination. It is national in the sense that it is a single customs area to which uniform domestic laws and business regulations apply. Otherwise, it is largely a collection of market islands separated by mountainous barriers that cannot be surmounted except at considerable economic cost. The nearest thing to a fairly concentrated market of respectable size is the Caracas-La Guaira-Maracay-Valencia sector, the units of which are linked together by a good highway system over which merchandise moves at moderate expense. The Maracay-Valencia area is also connected by cheap water transport with the country's second city, Maracaibo. Otherwise, the market islands are quite distant costwise: the Andean cities are themselves separated by formidable mountain barriers in the main; many of the oil camps are located in the interior of the country, separated from centers of home production by water and land barriers; and towns in the Llanos are even less accessible as a rule than the interior oil camps.

Distances between market centers are shrinking economi-

cally, however. New and modern highway systems are going up all the time, so that it will not be long before all major centers are connected by fast mountainous roads. Large and efficient trucks, more or less of the size that are common in the United States, should soon provide less expensive transport between major points. In addition, Venezuela already benefits from an extensive airfreight network that covers all major cities and towns in the country, generally on a daily basis. Considerable tonnages of such products as meat move by air from interior producing points to the main cities. As the market centers grow, unit costs of transport should decline, inasmuch as it will be possible to use larger truck and airplane capacity to move merchandise.

Lack of Cheap Electric Power. The cheapest power now available for off-peak industrial use costs over twice the average United States level on a similar basis. What is more, only a few utility companies even sell power at off-peak rates to industrial users. The result is high power costs per unit of finished product in those industrial uses, such as some of the main chemical products, which require considerable quantities of power.

In the not-too-distant future, however, the Caroní falls are sure to be harnessed, so that Venezuela will have an abundance of cheap power. (Some efficient thermoelectric plants are also going up, using cheap natural gas.) As has already been mentioned, these falls are located in several stages, each slightly separated from the other, at points not far from the confluence of the Orinoco and Caroní Rivers. The falls thus are subject to harnessing in stages, more or less in line with the growth of power requirements in that general area.

Recapitulation. The gist of the foregoing remarks is that there are formidable problems that face large-scale industrial development in Venezuela. High labor, capital, power, and transport costs combined with a limited market are likely to handicap industries for some time. This does not mean, however, that the outlook is bleak for new industries. In fact, new industries are appearing on the scene almost by the month, generally with the aid of liberal tariff protection, and/or the exoneration of taxes and import duties. What it means is that it will be necessary to proceed with care in fostering new industries, if the country is not to be burdened with a long

list of uneconomic activities. Specifically, it means that a thoroughgoing attempt should be made to assist new industries on a priority basis, in terms of lowness of relative costs of production, and with a new kind of assistance that gives reasonable promise of safeguarding the interests of consumers while affording minimum necessary protection to risk capital. The capital-subsidy arrangement appears to be such a form of assistance for the economic fostering of new industries.

Argentine Relations with the Export-Import Bank, 1934-1945

By EDWARD O. ELSASSER*

One of the major factors conditioning economic and political relations between the United States and Argentina has been the complementary nature of their individual economies. Thus, while a persistent demand exists in Argentina for the products of United States factories a comparatively non-existent market awaits the products of Argentine estancias in the northern country. Argentina is, therefore, eternally hard-pressed to acquire a sufficient supply of United States dollars to pay for the goods which could be supplied readily from the United States. To render the situation even more exasperating to the Argentine mind, certain influential live-stock and agrarian interests in the United States have succeeded in banning the import of Argentine beef into the United States on the somewhat specious, somewhat tenable ground that such imports carry the threat of hoof-and-mouth disease infection to United States herds. Not only is this a bitter pill for the Argentine exporter to swallow, but also the implied insult to the succulent pride of the peoples of the pampas eternally aggravates a most sensitive nerve end.

A concomitant of this economic difficulty is an apparently irreconcilable political estrangement between these two powerful nations. Inter-American conferences, in particular, have been the unfortunate victims of the backlash of this conflict. Only at such meetings as Montevideo in 1933 and Buenos Aires in 1936 did a semblance of harmony prevail. The nadir in these conference disagreements was reached at the third Foreign Ministers' conference held in Rio de Janeiro in January, 1942. A major factor precluding the issuance of a unified, definitive challenge to the Axis was Argentine refusal to accede to the wishes of the majority of the nations of the hemisphere. The result was the adoption of a resolution "recommending" that the Americas sever all ties with the totalitarian states. From

* Assistant Professor of History, Western Michigan College, Kalamazoo, Michigan.

this date onward the hard-won semblance of political and diplomatic accord achieved between the United States and Argentina during the late 1930's slowly but steadily deteriorated.

The Export-Import Bank functioned in a very limited way in this inhospitable economic and political environment. From the time Eximbank was established until the end of 1939 only seven credits applying to Argentina were entered on the Bank's ledgers. These credits were drawn up in favor of United States producers of such capital goods as motor trucks, oil refinery equipment, and railway engines, cars, and equipment. Six of these seven credits were never utilized and only $120,000 was disbursed for railway equipment on the one credit authorized and utilized. In the period then, when the Bank's function was primarily to aid the domestic economy through the promotion of foreign trade, little change was effected in the existing state of that trade with Argentina.

In 1940 three commitments totalling $82,420,000 were made in favor of Argentina. Since the total Eximbank commitments to that nation during the entire 1934-1945 period amounted to only $93,480,000 it will be readily appreciated that 1940 was an extraordinary year. A number of factors account for this sudden show of interest some of which apply to Latin America generally, some to Argentina in particular. This was a key year in the history of United States-Latin American relations, for latent threats to hemispheric security had become active, and the United States was exerting a considerable effort to assist the American republics in their struggle to maintain domestic economic stability. The loss of traditional European markets threatened this stability in many countries, particularly in a nation like Argentina which relied so heavily on those markets.

This instability provided a seed-bed for extremists with promising nostrums, and the Argentine climate seemed particularly conducive to a flowering of the totalitarian ideology. Early in 1940 German business agents were blithely taking orders and promising delivery in September or October of that year, thus giving the Argentines pause in taking any step toward alienating the possible new masters of Europe. On June 25, 1940, Senator Matías Sánchez Sorondo, vice president of the Argentine Senate, argued in that chamber that instead of antagonizing the German, Italian, and Spanish regimes Argentina should send a commission to Europe to study how best

she might cooperate with them, particularly in economic matters. Events in the Old World indicated a new order was rising, a new order which could have a vital influence on Argentine economic habits, and the nation must not remain outside while this new order was being constructed.[1] Sorondo was certainly not voicing a unanimous Argentine opinion as Senator Alfredo Palacios, the renowned Socialist statesman, was quick to point out. Palacios decried the evidences of all forms of totalitarianism that were cropping up in Argentina and stoutly defended traditional Argentine democratic beliefs.[2] The virus was working, however, and extraordinary measures would be necessary if it were to be kept in check.

Financial assistance seemed a most effective immediate step, but a mixed climate of opinion existed in Argentina regarding such a measure, the general tenor of expressed attitudes being that Argentines would prefer to earn United States dollars through trade rather than through loans. Speaking for those sympathetic to United States assistance, President Roberto Ortiz stated in 1939 that

> the United States have helped other Latin American countries and at the same time have helped themselves by assisting purchases of North American products when the countries concerned were not in a position to pay in dollars. Argentina is a country with a sound financial record and with a brilliant future before it. It should be worthwhile, therefore, to cultivate its friendship on a basis of reciprocity.[3]

On the other hand, the editors of *La Prensa* (Buenos Aires) were not so certain that such arrangements provided the proper solution to the problem. They sensed a growing conviction in Argentina that United States efforts to open credits designed to facilitate Latin-American trade and to organize "economic resistance to a presumed penetration by foreign countries working in this continent" were little more than useless. Public and official opinion in Argentina had long been aware of how an improvident use of credit and the extending

---

[1] Argentine Republic, Congreso, Cámara de Senadores, *Diario de Sesiones, de 26 de abril a 29 de agosto de 1940* (Buenos Aires: Cuerpo de Taquígrafos del Senado de la Nación, 1940), Tomo 1, 448.

[2] *Ibid.*, pp. 473-80.

[3] *La Nación* (Buenos Aires), February 3, 1939, as cited in *Review of the River Plate*, LXXXVI (February 10, 1939), 12.

of public loans repayable other than by the course of international trade "conspired against" economic independence. *La Prensa* was certain, however, that those responsible for United States economic policy

> were becoming convinced of the utter absurdity of a system whereby countries capable of the economic production of commodities for which, in the United States there is a constant and important demand, should be compelled to have recourse to credit operations which are as undesirable as they are unnecessary.[4]

Events soon challenged the validity of this certainty, however, for by the end of the year the United States had extended credits of $80,000,000 through two Export-Import Bank credits and, additionally, a grant of $50,000,000 from the United States Treasury Stabilization Fund. Apparently, official Argentine attitudes did not coincide with those put forward by *La Prensa* for according to the statement of Jesse Jones at the time he announced the first Eximbank credit, "they asked for the money for the purposes indicated, and we loaned it to them."[5] The terms of the first 1940 credit provided that $20,000,000 would be placed at the disposal of the Central Bank in two installments; the first, $12,000,000, and then $8,000,000 when this had been absorbed. Repayment was to be in three equal installments at the end of one, two, and three years with an interest rate of 3.60 per cent. The Central Bank would make the funds available for sale by private Argentine banks to industrial and commercial enterprises to carry out development work in reproductive enterprises, to aid employment, and to improve the exploitation and utilization of the nation's natural resources.[6]

It was apparently over a difference of interpretation of this last point that the credit came a cropper. In the view of Warren Lee Pierson, president of Eximbank, the credit was to be used exclusively in the United States for the purchase of machinery and material for heavy industry. In no way would

---

[4] Cited in *Review of the River Plate*, LXXXVIII (February 16, 1940), 14-15.

[5] *New York Times*, June 27, 1940, p. 20.

[6] *Review of the River Plate*, LXXXVIII (June 28, 1940), 17-19; *Commerce Reports*, July 20, 1940, p. 625; Siegfried Stern, *The United States in International Banking* (New York: Columbia University Press, 1951), p. 141.

the proceeds of the credit be used to foster developments which might compete with existing United States capital investments in Argentina. Argentine plans for utilization of the $20,000,000 went distinctly contrary to this intent. A specific project the authorities of that country had in mind was the construction of a pipeline from the government oil fields in Mendoza province to Buenos Aires. The remainder of the credit would be turned over to the state petroleum monopoly, Yacimientos Petroliferos Fiscales (Y.P.F.).[7] This would compensate for the loss of coal supplies from England and make Argentina less dependent on European sources of supply in the future. Since there were United States-owned petroleum companies operating in the Mendoza area, an impasse developed which undoubtedly contributed to the ultimate cancellation of the entire credit.[8]

As the year 1940 advanced, the Argentine situation became increasingly desperate. In an attempt to east the strain on gold and dollar reserves a financial mission was dispatched to Washington in November, 1940, to discuss ways and means of resolving the problem.[9] The belief prevailed quite generally that the visit of Warren Pierson to Buenos Aires the preceding September had paved the way for the mission, for the United States was as anxious as Argentina to resolve the difficulties between the two nations in the interests of hemispheric economic and political accord.[10]

The outcome of the Washington talks was made public in the two announcements of December 5 and 11. On the former date Treasury Secretary Henry Morgenthau revealed that $50,000,000 would be made available to Argentina from the United States Treasury's gold stabilization fund.[11] The determination of the Washington Administration to strew the thorny path of Argentine-United States relations with a carpet of dollars was further emphasized by the second of the an-

---

[7] *New York Times*, October 3, 1940, p. 9, October 19, 1940, p. 23; *Review of the River Plate*, LXXXVIII (June 28, 1940), 17-19; *Commercial and Financial Chronicle*, CL (June 29, 1940), 4053; *Commerce Reports*, July 20, 1940, p. 625; *Business Week*, July 6, 1940, p. 54.

[8] *New York Times*, October 19, 1940, p. 23.

[9] *Ibid.*, September 27, 1940, p. 5, January 2, 1941, p. 35; *Business Week*, September 28, 1940, p. 61, November 30, 1940 p. 64.

[10] *New York Times*, November 8, 1940, p. 6, November 13, 1940, p. 12; *Review of the River Plate*, LXXXIX (September 27, 1940), 28.

[11] *New York Times*, December 6, 1940, p. 1.

nouncements noted above. This revealed that the Export-Import Bank had authorized a $60,000,000 credit to Argentina. Some such move had been forecast on Dcember 5 when Warren Pierson had remarked that he "would hate to see the Treasury do better than the bank."[12] The credit was to be made available to the Central Bank of Argentina at the rate of $5,000,000 a month over the ensuing year. It would be amortized over a six-year period at an interest rate of 3.60 per cent per annum, and incorporated in its total was the $20,000,000 credit granted earlier in the year.[13] According to Jesse Jones, the loan was designed to aid Argentina in making purchases in the United States, for during the previous ten months United States exports to Argentina had almost doubled over the similar period in the preceding year while imports from Argentina had increased only fifty per cent.[14]

The Argentine Congress recessed in 1941 without acting on the credit agreement, and as events were to prove, it was never utilized. The most obvious explanation of this failure to seize what seemed to be the golden opportunity will be found in the statistics of Argentine-United States trade. In 1941 Argentina's exports to the United States doubled in value over what they had been in the preceding year, and from 1941 forward Argentina maintained a highly favorable export balance in her trade with the United States. In fact as the months went on, the problem was no longer one of finding sufficient dollar exchange to purchase essential gods, but of finding sufficient essential goods on which to expend a surplus of dollar exchange.

To all intents and purposes, this credit marked the end of Eximbank relations with the Argentine Republic during the period under study. Two individual $500,000 credits were extended to private mining interests in Argentina in February, 1942, but they were utilized only in part. Throughout the entire period under consideration, in fact, only $390,000 of Export-Import Bank funds were disbursed in the interests of Argentina, and these in the critical 1939-1942 period. When

---

[12] *Ibid.*

[13] *Ibid.*, December 12, 1940, p. 7; *Review of the River Plate*, LXXXIX (December 13, 1940), 11; *Commercial and Financial Chronicle*, CLI (December 28, 1940), 3816; Stern, *United States in International Banking*, p. 141.

[14] *New York Times*, December 12, 1940, p. 7.

one fits the Bank's activity, or lack of activity, into the larger picture of Argentine-United States relations the role played by political influences in inducing this inertia becomes apparent. Prior to 1939 Argentine's traditional antagonism to the United States, coupled with her habits of trade with Europe rendered any sort of reconciliation or cooperation between the two nations impossible. In the difficult European phase of World War II, both the United States and Argentina sensed a need for mutual reliance and support, a need implemented by a certain measure of cooperation such as that offered by Eximbank. When the war burst over the Americas, it soon became apparent that for a number of reasons, historic and immediate, Argentina had determined to follow her own course. United Nations dependence on a number of products of forest and pampa granted Argentina economic security and independence of action in spite of her failure to cast her lot with the Allies. There existed, therefore, neither the need nor the desire for further Eximbank interest in Argentina. The two continental protagonists had taken each other's measure, and the differences between them would have to be settled on the highest political levels. The situation had passed the point where Eximbank, acting even in its most blatant political robes, could influence the outcome.